

eHealth, Inc.  
Form 10-Q  
November 10, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**▶ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 30, 2008

OR

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

001-33071

(Commission File Number)

**EHEALTH, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**440 EAST MIDDLEFIELD ROAD**

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**MOUNTAIN VIEW, CALIFORNIA 94043**

**(Address of principal executive offices)**

**(650) 584-2700**

**(Registrant's telephone number, including area code)**

**Not Applicable**

**(Former name, former address and former fiscal year, if changed since last report)**

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of October 31, 2008 was 25,077,349 shares.

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**PART I**  
**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS****EHEALTH, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

|   | <b>December 31,<br/>2007</b> | <b>September 30,<br/>2008<br/>(unaudited)</b> |
|---|------------------------------|---|
| <b>Assets</b>                                 |                              |   |
| Current assets:                               |                              |   |
| Cash and cash equivalents                     | \$ 81,395                    | \$ 90,525                                     |
| Marketable securities                         | 40,119                       | 52,731  |
| Accounts receivable                           | 1,300                        | 1,560   |
| Deferred income taxes                         | 13,240                       | 6,582   |
| Prepaid expenses and other current assets     | 2,098                        | 1,482   |
| Total current assets                          | 138,152                      | 152,880                                       |
| Property and equipment, net                   | 3,791                        | 4,762   |
| Deferred income taxes                         | 4,535                        | 4,535   |
| Other assets                                  | 975                          | 955   |
| Total assets                                  | \$ 147,453                   | \$ 163,132                                    |
| <b>Liabilities and stockholders equity</b>    |                              |   |
| Current liabilities:                          |                              |   |
| Accounts payable                              | \$ 1,495                     | \$ 1,855                                      |
| Accrued compensation and benefits             | 4,849                        | 4,003   |
| Accrued marketing expenses                    | 2,454                        | 3,942   |
| Deferred revenue                              | 436                          | 351   |
| Other current liabilities                     | 2,073                        | 2,272   |
| Total current liabilities                     | 11,307                       | 12,423  |
| Other non-current liabilities                 | 252                          | 432   |
| Commitments and contingencies                 |                              |   |
| Stockholders equity:                          |                              |   |
| Preferred stock                               |                              |   |
| Common stock                                  | 25                           | 25  |
| Additional paid-in capital                    | 167,847                      | 172,032                                       |
| Deferred stock-based compensation             | (104)                        | (40)  |
| Accumulated deficit                           | (32,060)                     | (21,541)                                      |
| Accumulated other comprehensive income (loss) | 186                          | (199)   |
| Total stockholders equity                     | 135,894                      | 150,277                                       |
| Total liabilities and stockholders equity     | \$ 147,453                   | \$ 163,132                                    |

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

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

|   | <b>Three Months<br/>Ended<br/>September 30,</b> |                 | <b>Nine Months Ended<br/>September 30,</b> |                  |
|---|---|-----------------|--|------------------|
|   | <b>2007</b>                                     | <b>2008</b>     | <b>2007</b>                                | <b>2008</b>      |
| <b>Revenue:</b>   |   |                 |  |                  |
| Commission  | \$ 21,313                                       | \$ 25,788       | \$ 59,486                                  | \$ 74,663        |
| Sponsorship, licensing and other                                    | 1,684   | 2,687           | 4,072                                      | 7,593            |
| <b>Total revenue</b>  | <b>22,997</b>                                   | <b>28,475</b>   | <b>63,558</b>                              | <b>82,256</b>    |
| <b>Operating costs and expenses:</b>                                |   |                 |  |                  |
| Cost of revenue-sharing   | 427   | 469             | 1,245                                      | 1,338            |
| Marketing and advertising   | 7,309   | 11,502          | 21,021                                     | 30,633           |
| Customer care and enrollment  | 3,002   | 3,722           | 8,859                                      | 10,655           |
| Technology and content  | 3,108   | 3,565           | 9,025                                      | 10,548           |
| General and administrative  | 4,308   | 4,731           | 11,698                                     | 13,475           |
| <b>Total operating costs and expenses</b>                           | <b>18,154</b>                                   | <b>23,989</b>   | <b>51,848</b>                              | <b>66,649</b>    |
| <b>Income from operations</b>                                       | <b>4,843</b>                                    | <b>4,486</b>    | <b>11,710</b>                              | <b>15,607</b>    |
| Interest and other income, net                                      | 1,403   | 935             | 3,849                                      | 3,085            |
| <b>Income before income taxes</b>                                   | <b>6,246</b>                                    | <b>5,421</b>    | <b>15,599</b>                              | <b>18,692</b>    |
| Provision for income taxes  | 2,516   | 2,400           | 6,324                                      | 8,173            |
| <b>Net income</b>   | <b>\$ 3,730</b>                                 | <b>\$ 3,021</b> | <b>\$ 9,235</b>                            | <b>\$ 10,519</b> |
| <b>Comprehensive income:</b>  |   |                 |  |                  |
| Net income  | \$ 3,730  | \$ 3,021        | \$ 9,235                                   | \$ 10,519        |
| Change in unrealized gain (loss) on investments, net of taxes       | 49  | (419)           | 43   | (454)            |
| Foreign currency translation adjustment, net of taxes               | 17  | 4               | 47   | 69               |
| <b>Total comprehensive income</b>                                   | <b>\$ 3,796</b>                                 | <b>\$ 2,606</b> | <b>\$ 9,325</b>                            | <b>\$ 10,134</b> |
| <b>Net income per share:</b>  |   |                 |  |                  |
| Basic   | \$ 0.16   | \$ 0.12         | \$ 0.41                                    | \$ 0.42          |
| Diluted   | \$ 0.14   | \$ 0.12         | \$ 0.36                                    | \$ 0.40          |
| <b>Weighted-average number of shares used in per share amounts:</b> |   |                 |  |                  |
| Basic   | 23,517  | 25,060          | 22,643                                     | 24,925           |
| Diluted   | 26,263  | 25,921          | 25,746                                     | 26,007           |

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

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

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2007</b>                                | <b>2008</b> |
| <b>Operating activities</b>   |  |             |
| Net income  | \$ 9,235                                   | \$ 10,519   |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |
| Deferred income taxes   | 6,109                                      | 7,146       |
| Depreciation and amortization   | 1,275                                      | 1,271       |
| Stock-based compensation expense  | 962  | 2,609       |
| Excess tax benefits from stock-based compensation                                 |  | (216)       |
| Deferred rent expense   | (22)                                       | (43)        |
| Loss on disposal of property and equipment  | 18   | 39          |
| Changes in operating assets and liabilities:                                      |  |             |
| Accounts receivable   | (331)                                      | (260)       |
| Prepaid expenses and other current assets   | 184  | 456         |
| Other assets  | (523)                                      | 21          |
| Accounts payable  | (302)                                      | 357         |
| Accrued compensation and benefits   | (67)                                       | (700)       |
| Accrued marketing expenses  | 776  | 1,488       |
| Deferred revenue  | 215  | (85)        |
| Other current liabilities   | 753  | 148         |
| Net cash provided by operating activities   | 18,282                                     | 22,750      |
| <b>Investing activities</b>   |  |             |
| Purchases of property and equipment   | (1,053)                                    | (2,242)     |
| Proceeds from the sale of property and equipment                                  | 14   |             |
| Purchases of marketable securities  | (36,520)                                   | (61,565)    |
| Sales of marketable securities  | 2,156                                      | 10,120      |
| Maturities of marketable securities   | 588  | 38,379      |
| Net cash used in investing activities   | (34,815)                                   | (15,308)    |
| <b>Financing activities</b>   |  |             |
| Net proceeds from exercise of common stock options                                | 5,343                                      | 1,426       |
| Excess tax benefits from stock-based compensation                                 |  | 216         |
| Principal payments in connection with capital leases                              | (212)                                      |             |
| Costs incurred in connection with initial public offering                         | (252)                                      |             |
| Net cash provided by financing activities   | 4,879                                      | 1,642       |
| Effect of exchange rate changes on cash and cash equivalents                      | 64   | 46          |
| Net (decrease) increase in cash and cash equivalents                              | (11,590)                                   | 9,130       |
| Cash and cash equivalents at beginning of period                                  | 90,316                                     | 81,395      |
| Cash and cash equivalents at end of period  | \$ 78,726                                  | \$ 90,525   |

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



**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

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

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

**Basis of Presentation** The accompanying condensed consolidated balance sheet as of September 30, 2008, the condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2007 and 2008 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2007 and 2008 are unaudited. The condensed consolidated balance sheet data as of December 31, 2007 was derived from the audited consolidated financial statements which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which was filed with the Securities and Exchange Commission on March 17, 2008. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in our Annual Report on Form 10-K.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP, for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in our Annual Report on Form 10-K, and include all adjustments necessary for the fair presentation of eHealth's statement of financial position as of September 30, 2008, its results of operations for the three and nine months ended September 30, 2007 and 2008 and its cash flows for the nine months ended September 30, 2007 and 2008. All adjustments are of a normal recurring nature. The results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending December 31, 2008.

**Significant Customers** Revenue for all periods presented was generated from customers located solely in the United States. The following carriers (or carriers owned by them) represented 10% or more of our total revenue for the three and nine months ended September 30, 2007 and 2008 (unaudited):

|                  | Three Months Ended    |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 30,<br>2007 | September 30,<br>2008 | September 30,<br>2007 | September 30,<br>2008 |
| UnitedHealthcare | 18%                   | 17%                   | 19%                   | 17%                   |
| Wellpoint        | 17%                   | 16%                   | 18%                   | 16%                   |
| Aetna            | 12%                   | 14%                   | 11%                   | 13%                   |

Revenue attributable to individual and family product offerings represented approximately 85% of our commission revenue in the three and nine months ended September 30, 2007, and represented approximately 88% and 87% of our commission revenue in the three and nine months ended September 30, 2008, respectively. We define individual and family product offerings as major medical individual and family health insurance plans, which does not include small business, short-term major medical, stand-alone dental, life and student health insurance product offerings.

**Disposal of Capital Equipment** During the three and nine months ended September 30, 2008, we disposed of certain capital equipment, primarily computer equipment and software, with a gross book value of \$0.7 million. The net book value of these assets was not significant at the time of their disposal and we recorded an immaterial loss in our condensed consolidated statements of income and comprehensive income as a result of their disposal. During the three and nine months ended September 30, 2007, we disposed of certain computer equipment, software and office equipment with a gross book value of \$2.0 million. The net book value of these assets was not significant at the time of their disposal and we recorded an immaterial loss in our condensed consolidated statements of income and comprehensive income as a result of their disposal.

**Recent Accounting Pronouncements** We implemented SFAS No. 157 ( SFAS 157 ), *Fair Value Measurement*, effective January 1, 2008 for our financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that

are re-measured and reported at fair value at least annually. In

**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

accordance with the provisions of FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, we have elected to defer until January 1, 2009 the implementation of SFAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The partial adoption of SFAS 157 did not have a material impact on our consolidated financial position, results of operations or cash flows.

We adopted SFAS No. 159 ( SFAS 159 ), *The Fair Value Option for Financial Assets and Financial Liabilities*, effective January 1, 2008. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The implementation of SFAS 159 did not have an impact on our consolidated financial position, results of operations or cash flows, as we did not elect to adopt the fair value option under this Statement.

In October 2008, the FASB issued Staff Position (FSP) No. FAS 157-3 (FSP 157-3), *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, which clarifies the application of Statement No. 157 in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. The Staff Position is effective immediately and applies to prior periods for which financial statements have not been issued, including interim or annual periods ending on or before September 30, 2008. The implementation of FAS 157-3 did not have an impact on our consolidated financial position, results of operations or cash flows.

**Note 2 Cash, Cash Equivalents and Marketable Securities**

**Cash and Cash Equivalents** Cash equivalents are comprised primarily of highly liquid available-for-sale financial instruments with an original maturity of 90 days or less from the date of purchase. As of September 30, 2008, our money market funds consisted primarily of federal agency securities. The cost, unrealized gains and losses, net of taxes, and estimated fair value of our cash equivalents consisted of the following as of September 30, 2008 and December 31, 2007 (in thousands):

|   | Cost      | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---|-----------|---------------------|----------------------|-------------------------|
| <b>September 30, 2008</b> (unaudited)               |           |                     |                      |                         |
| Cash  | \$ 1,288  | \$                  | \$                   | \$ 1,288                |
| Cash equivalents:                                   |           |                     |                      |                         |
| Money market funds                                  | 76,254    |                     |                      | 76,254                  |
| Commercial paper                                    | 10,484    |                     | 1                    | 10,483                  |
| U.S. government-sponsored enterprise discount notes | 1,498     | 2                   |                      | 1,500                   |
| U.S. government-sponsored enterprise bonds          | 1,000     |                     |                      | 1,000                   |
| Total cash equivalents                              | 89,236    | 2                   | 1                    | 89,237                  |
| Total cash and cash equivalents                     | \$ 90,524 | \$ 2                | \$ 1                 | \$ 90,525               |
| <b>December 31, 2007</b>                            |           |                     |                      |                         |
| Cash  | \$ 4,580  | \$                  | \$                   | \$ 4,580                |
| Cash equivalents:                                   |           |                     |                      |                         |
| Money market funds                                  | 55,292    |                     |                      | 55,292                  |
| Commercial paper                                    | 21,521    | 2                   |                      | 21,523                  |
| Total cash equivalents                              | 76,813    | 2                   |                      | 76,815                  |

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|                                 |           |    |   |    |           |
|---------------------------------|-----------|----|---|----|-----------|
| Total cash and cash equivalents | \$ 81,393 | \$ | 2 | \$ | \$ 81,395 |
|---------------------------------|-----------|----|---|----|-----------|

We did not realize any significant gains or losses on sales of cash equivalents during the three and nine months ended September 30, 2007 and 2008.

**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

**Marketable Securities** Marketable securities are comprised primarily of highly liquid available-for-sale financial instruments with original maturities of more than 90 days from the date of purchase. Marketable securities that are available for use in current operations are classified as current assets in the accompanying condensed consolidated balance sheets regardless of the remaining time to maturity. The cost, unrealized gains and losses, net of taxes, and estimated fair value of our marketable securities consisted of the following as of September 30, 2008 and December 31, 2007 (in thousands):

|   | Cost             | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---|------------------|---------------------|----------------------|-------------------------|
| <b>September 30, 2008</b> (unaudited)               |                  |                     |                      |                         |
| U.S. government-sponsored enterprise bonds          | \$ 18,344        | \$ 9                | \$ 27                | \$ 18,326               |
| Corporate bonds                                     | 17,505           | 7                   | 389                  | 17,123                  |
| U.S. government-sponsored enterprise discount notes | 10,565           | 4                   | 2                    | 10,567                  |
| Commercial paper                                    | 5,716            |                     | 1                    | 5,715                   |
| Certificates of deposit                             | 1,000            |                     |                      | 1,000                   |
| <b>Total marketable securities</b>                  | <b>\$ 53,130</b> | <b>\$ 20</b>        | <b>\$ 419</b>        | <b>\$ 52,731</b>        |
| <b>December 31, 2007</b>                            |                  |                     |                      |                         |
| Corporate bonds                                     | \$ 15,368        | \$ 36               | \$ 6                 | \$ 15,398               |
| Commercial paper                                    | 13,047           | 2                   |                      | 13,049                  |
| U.S. government-sponsored enterprise bonds          | 11,298           | 25                  | 1                    | 11,322                  |
| Certificates of deposit                             | 350              |                     |                      | 350                     |
| <b>Total marketable securities</b>                  | <b>\$ 40,063</b> | <b>\$ 63</b>        | <b>\$ 7</b>          | <b>\$ 40,119</b>        |

We did not realize any significant gains or losses on sales of marketable securities during the three and nine months ended September 30, 2007 and 2008.

During the three and nine months ended September 30, 2008, we incurred net unrealized losses on our marketable securities of \$0.4 million and \$0.5 million, respectively. Net unrealized gains and losses incurred on our marketable securities during the three and nine months ended September 30, 2007 were not significant. Net unrealized losses are the result of the change in fair value of our investments in marketable securities, primarily corporate bonds, at the beginning and end of the period and are excluded from earnings and reported as a component of stockholders' equity in the condensed consolidated balance sheets and in comprehensive income on the condensed consolidated statements of income and comprehensive income.

At September 30, 2008, we evaluated each of our unrealized losses, the majority of which are from corporate bonds, and determined them to be temporary in accordance with Emerging Issues Task Force (EITF) Abstract No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. Factors we considered in determining whether unrealized losses were temporary included the length of time and extent to which each investment's fair value has been less than its cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Based upon our evaluation of these factors, and because we have the ability and intent to hold each of our investments with net unrealized losses until their respective maturity dates, we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

The contractual maturities of our marketable securities as of December 31, 2007 and September 30, 2008, were as follows (in thousands):

|                                    | Estimated Fair Value as of<br>December 31, 2007 | Estimated Fair Value as of<br>September 30, 2008<br>(unaudited) |
|------------------------------------|---|---|
| Due within 1 year                  | \$ 28,219                                       | \$ 48,054   |
| Due within 1 year to 2 years       | 11,900  | 4,677   |
| <b>Total marketable securities</b> | <b>\$ 40,119</b>                                | <b>\$ 52,731</b>  |

**Note 3 Fair Value Measurements**

SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly

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transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or Inputs other than quoted prices that are observable for the asset or liability
- Level 3 Unobservable inputs for the asset or liability

The following table presents information about our financial assets (cash equivalents and marketable securities) that are re-measured and reported at fair value on a recurring basis as of September 30, 2008, and indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value (in thousands, unaudited):

|   | As of September 30, 2008   |  |            |
|---|--|--|------------|
|   | Quoted Prices<br>In<br>Active Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Total      |
| <b>Cash equivalents:</b>                            |  |  |            |
| Money market funds                                  | \$ 76,254  | \$   | \$ 76,254  |
| Commercial paper                                    |  | 10,483   | 10,483     |
| U.S. government-sponsored enterprise discount notes |  | 1,500  | 1,500      |
| U.S. government-sponsored enterprise bonds          |  | 1,000  | 1,000      |
|   | 76,254   | 12,983   | 89,237     |
| <b>Marketable securities:</b>                       |  |  |            |
| U.S. government-sponsored enterprise bonds          |  | 18,326   | 18,326     |
| Corporate bonds                                     |  | 17,123   | 17,123     |
| U.S. government-sponsored enterprise discount notes |  | 10,567   | 10,567     |
| Commercial paper                                    |  | 5,715  | 5,715      |
| Certificates of deposit                             |  | 1,000  | 1,000      |
|   |  | 52,731   | 52,731     |
| Total cash equivalents and marketable securities    | \$ 76,254  | \$ 65,714  | \$ 141,968 |

We endeavor to utilize the best available information in measuring fair value. We used observable prices in active markets in determining the classification of our money market funds as Level 1. For our other cash equivalents and marketable securities classified as Level 2, we primarily relied on observable quotes in active markets; however if we concluded the market was non-active, we relied on independent market pricing data. We did not hold any financial assets as of September 30, 2008 whereby the fair value measurements are estimated using significant

unobservable inputs (Level 3).

**Note 4 Stockholders' Equity and Stock-Based Compensation**

**Stockholders' Equity**

**Stock Plans** Our 2006 Equity Incentive Plan (the 2006 Plan ) became effective in October 2006. As of September 30, 2008, we had 2,909,252 shares of our common stock available for future grants under the 2006 Plan. On January 1 of each year, the number of shares available for future grant under the 2006 Plan will automatically increase by the lowest of (a) 1,500,000 shares, (b) 4% of the total number of shares of our common stock then outstanding or (c) a lower number determined by our board of directors or its compensation committee. As of January 1, 2008, shares reserved under the 2006 Plan automatically increased by 987,473 shares, which equaled 4% of the total number of shares of our common stock then outstanding.



**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

The following table summarizes activity under all of our stock plans ( Stock Plans ) (in thousands, except per share amounts and weighted-average remaining contractual life data, unaudited):

|                                  | Shares<br>Available<br>for<br>Grant | Number of<br>Options<br>Outstanding | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Life (years) | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|-------------------------------------|-------------------------------------|---|--|---------------------------------|
| Balance at December 31, 2007     | 2,464                               | 2,626                               | \$ 7.44                                   |  |                                 |
| Additional shares authorized (1) | 987                                 |                                     |   |  |                                 |
| Shares expired (2)               | (14)                                |                                     |   |  |                                 |
| Options granted                  | (497)                               | 497                                 | \$ 21.95                                  |  |                                 |
| Restricted stock granted         | (195)                               |                                     |   |  |                                 |
| Options exercised                |                                     | (380)                               | \$ 3.91                                   |  |                                 |
| Options cancelled                | 154                                 | (154)                               | \$ 24.13                                  |  |                                 |
| Restricted stock cancelled       | 10                                  |                                     |   |  |                                 |
| Balance at September 30, 2008    | 2,909                               | 2,589                               | \$ 9.75                                   | 6.11   | \$ 20,977                       |

- (1) On January 1, 2008, the number of shares authorized for issuance under the 2006 Plan was automatically increased pursuant to the terms of the 2006 Plan by 987,473 shares.
- (2) The 1998 Stock Plan and 2005 Stock Plan were terminated with respect to the grant of additional shares upon the effective date of the registration statement related to our initial public offering in October 2006, resulting in reductions in the total number of authorized shares from the expiration of unvested grants.
- The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying stock options and the fair value of our common stock at September 30, 2008.

The fair value of stock options granted to employees for the three and nine months ended September 30, 2007 and 2008 was estimated using the following weighted-average assumptions (unaudited):

|                             | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-----------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                             | 2007                                | 2008      | 2007                               | 2008      |
| Expected term               | 6.1 years                           | 6.1 years | 6.1 years                          | 4.8 years |
| Expected volatility         | 59.6%                               | 57.4%     | 59.6%                              | 54.9%     |
| Expected dividend yield     | 0%                                  | 0%        | 0%                                 | 0%        |
| Risk-free interest rate     | 4.48%                               | 3.48%     | 4.48%                              | 3.15%     |
| Weighted-average fair value | \$ 14.63                            | \$ 8.41   | \$ 13.04                           | \$ 10.78  |

The following table summarizes restricted stock unit activity under the Stock Plans (in thousands, except weighted-average remaining contractual life data, unaudited):

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|   | <b>Number of<br/>Restricted Stock<br/>Units<br/>Outstanding</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Life (years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---|---|---|--|
| Balance as of December 31, 2007         | 23  |   |  |
| Granted                                 | 195   |   |  |
| Cancelled                               | (7)   |   |  |
| Vested                                  | (10)  |   |  |
| <b>Balance as of September 30, 2008</b> | <b>201</b>  | <b>1.85</b>   | <b>\$ 3,212</b>                          |

The aggregate intrinsic value is calculated as the fair value at September 30, 2008 of the underlying common stock outstanding and vested and expected to vest as of September 30, 2008.

**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)****Stock-Based Compensation**

The following table summarizes stock-based compensation expense recorded during the three and nine months ended September 30, 2007 and 2008 (in thousands, unaudited):

|  | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |                 |
|--|---|---------------|--|-----------------|
|  | <b>2007</b>                                 | <b>2008</b>   | <b>2007</b>                                | <b>2008</b>     |
| <b>Awards granted to employees accounted for in accordance with SFAS 123R:</b> |   |               |  |                 |
| Common stock options   | \$ 267                                      | \$ 755        | \$ 712                                     | \$ 1,909        |
| Restricted stock units   | 50  | 182           | 138  | 634             |
| Restricted common stock  | 5   | 1             | 15   | 11              |
|  | 322   | 938           | 865  | 2,554           |
| <b>Awards granted to employees accounted for in accordance with APB 25:</b>    |   |               |  |                 |
| Common stock options   | 4   |               | 17   |                 |
| Restricted common stock  | 24  | 17            | 80   | 55              |
|  | 28  | 17            | 97   | 55              |
| <b>Total stock-based compensation expense</b>                                  | <b>\$ 350</b>                               | <b>\$ 955</b> | <b>\$ 962</b>                              | <b>\$ 2,609</b> |

The following table summarizes stock-based compensation expense by operating function included in the condensed consolidated statements of income for the three and nine months ended September 30, 2007 and 2008 (in thousands, unaudited):

|   | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |                 |
|---|---|---------------|--|-----------------|
|   | <b>2007</b>                                 | <b>2008</b>   | <b>2007</b>                                | <b>2008</b>     |
| Marketing and advertising                     | \$ 45                                       | \$ 151        | \$ 113                                     | \$ 484          |
| Customer care and enrollment                  | 30  | 49            | 86   | 200             |
| Technology and content                        | 143   | 203           | 416  | 653             |
| General and administrative                    | 132   | 552           | 347  | 1,272           |
| <b>Total stock-based compensation expense</b> | <b>\$ 350</b>                               | <b>\$ 955</b> | <b>\$ 962</b>                              | <b>\$ 2,609</b> |

**Note 5 Income Taxes**

On September 23, 2008, the state of California approved its budget for fiscal year ending June 30, 2009, which contained changes to the California tax law which substantially limit our ability to utilize available state net operating loss and tax credit carry forwards to reduce our state income taxes payable. Under the new tax law, the utilization of net operating loss carry forwards is suspended for tax years 2008 and 2009; however, the expiration date of the net operating loss carry forwards is extended for an equivalent two-year period. Additionally, for tax years 2008 and 2009, taxpayers may only utilize available tax credit carry forwards to reduce their current tax liability up to 50% of their net tax amount before application of such credits. The new law does not affect the amount of net operating loss or tax credit carry forwards that we

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expect to ultimately use to offset future California taxes; however, it does limit the amount of net operating loss and tax credit carry forwards that we will be able to utilize to reduce our taxes payable during the years ending December 31, 2008 and 2009, resulting in an increase in cash taxes payable to the state of California in those years. While we do not expect this change in the California tax law to impact our effective tax rate, we expect that our cash outlay for federal and state taxes will increase to approximately 4.5% of pre-tax income for the year ending December 31, 2008.

Under SFAS 123R, we consider stock option deduction benefits in excess of book compensation charges realized when we obtain an incremental benefit determined by the With and Without calculation method. Under the With and Without approach, excess tax benefits related to share-based payments are not deemed to be realized until after the utilization of all other tax benefits available to us. For example, net operating loss and tax credit carry forwards from prior years are used to reduce taxes currently payable prior to deductions from stock option exercises for purposes of financial reporting, while for

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**EHEALTH, INC.**

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

**(unaudited)**

tax return purposes, current year stock compensation deductions are generally used before net operating loss carry forwards. Indirect effects of excess tax benefits, such as the effect on research and development tax credits, are not considered. In accordance with SFAS 123R, only realized excess tax benefits are reflected in the financial statements.

During the three and nine months ended September 30, 2008, we recorded a provision for income taxes of \$2.4 million and \$8.2 million, respectively, representing an effective tax rate of approximately 44%. During the three and nine months ended September 30, 2007, we recorded a provision for income taxes of \$2.5 million and \$6.3 million, respectively, representing an effective tax rate of approximately 41%. Our deferred tax assets were reduced due to the extent we were able to utilize net operating loss and tax credit carry forwards to reduce taxes currently payable. In addition, due to the restriction on our ability to utilize net operating loss carry forwards to reduce taxes currently payable in California, we utilized excess tax benefits related to share-based payments and other unrecognized tax benefits, which resulted in a \$0.2 million increase in additional paid-in capital and a \$0.3 million increase in other non-current liabilities, respectively, in the condensed consolidated balance sheet as of September 30, 2008. Additionally, the \$0.2 million of realized excess tax benefits related to share-based payments is classified in the condensed consolidated statements of cash flows as both a financing cash inflow and an operating cash outflow.

We adopted the provisions of FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, on January 1, 2007. As of December 31, 2007 and September 30, 2008, we had approximately \$2.4 million and \$2.6 million, respectively, of unrecognized tax benefits. As of December 31, 2007 and September 30, 2008, there were \$2.0 million and \$2.1 million, respectively, of unrecognized tax benefits, that, if recognized, would impact the effective tax rate. Due to net operating losses, all tax years after 1998 are open to examination and adjustment.

On October 3, 2008, the *Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008 and Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (HR1424)* was signed into law, which, as enacted, includes a provision that retroactively extends the federal research and development tax credit from January 1, 2008 through December 31, 2009. Federal research and development tax credits for the year ending December 31, 2008, which are not expected to be material, will be included in our provision for income taxes for the three months ending December 31, 2008.

**Note 6 Net Income Per Share**

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding for the fiscal period. Diluted net income per share is computed giving effect to all potential dilutive common stock, including options, restricted stock and restricted stock units. The dilutive effect of outstanding awards is reflected in diluted earnings per share by application of the treasury stock method.

**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

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

|  | <b>Three Months Ended<br/>September 30,<br/>2007</b> |          | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |           |
|--|--|----------|---|-----------|
| Basic:   |  |          |   |           |
| Numerator:   |  |          |   |           |
| Net income allocated to common stock                                   | \$ 3,730   | \$ 3,021 | \$ 9,235  | \$ 10,519 |
| Denominator:   |  |          |   |           |
| Weighted average number of common stock shares                         | 23,517   | 25,060   | 22,643  | 24,925    |
| Net income per share basic:  | \$ 0.16  | \$ 0.12  | \$ 0.41   | \$ 0.42   |
| Diluted:   |  |          |   |           |
| Numerator:   |  |          |   |           |
| Net income allocated to common stock                                   | \$ 3,730   | \$ 3,021 | \$ 9,235  | \$ 10,519 |
| Denominator:   |  |          |   |           |
| Weighted average number of common stock shares                         | 23,517   | 25,060   | 22,643  | 24,925    |
| Weighted average number of options                                     | 2,730  | 859      | 3,089   | 1,064     |
| Weighted average number of restricted stock and restricted stock units | 16   | 2        | 14  | 18        |
| Total common stock shares used in per share calculation                | 26,263   | 25,921   | 25,746  | 26,007    |
| Net income per share diluted:  | \$ 0.14  | \$ 0.12  | \$ 0.36   | \$ 0.40   |

For each of the three and nine months ended September 30, 2007 and 2008, we had securities outstanding that could potentially dilute earnings per share, but the shares from the assumed conversion or exercise of these securities were excluded in the computation of diluted net income per share as their effect would have been anti-dilutive. The number of outstanding anti-dilutive weighted shares that were excluded from the computation of diluted net income per share consisted of the following (in thousands, unaudited):

|                        | <b>Three Months Ended<br/>September 30,<br/>2007</b> |       | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |     |
|------------------------|--|-------|---|-----|
| Common stock options   | 232  | 838   | 177   | 643 |
| Restricted stock units | 3  | 196   |   |     |
|                        | 235  | 1,034 | 177   | 643 |

**Table of Contents****EHEALTH, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)****Note 7 Geographic Information**

Revenue for all periods presented was generated from customers located solely in the United States. As of December 31, 2007 and September 30, 2008, our long-lived assets consisted primarily of property and equipment and indefinite-lived intangible assets. Our long-lived assets are attributed to the geographic location in which they are located. Long-lived assets by geographical area were as follows (in thousands):

|               | <b>As of<br/>December 31, 2007</b> | <b>As of<br/>September 30, 2008<br/>(unaudited)</b> |
|---------------|------------------------------------|---|
| United States | \$ 4,172                           | \$ 5,008  |
| China         | 594                                | 709   |
| <b>Total</b>  | <b>\$ 4,766</b>                    | <b>\$ 5,717</b>                                     |

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include, among other things, statements relating to expectations regarding our future effective tax rates and the amount of tax credits and cash outlay for taxes we will pay for 2008, including as a result of recent changes to California tax laws; our expectation that the rate of online adoption will continue to be a primary driver of revenue; an increase in our cost of acquiring members and factors impacting such increase; exploration of new marketing initiatives that increase per member acquisition costs; critical accounting policies and estimates and related impact on our financial statements; estimated commission forfeiture rates; expected term and volatility of stock based awards; our expectation to continue to grant equity awards in the future and that stock based compensation expense will increase and be material over time; realization of earnings to utilize deferred tax assets; our expectation to continue to utilize excess tax benefits related to share-based payments and other unrecognized tax benefits and the related impact on additional paid-in capital; our expectation that total revenue will increase in absolute dollars as a result of continued growth in our membership base and growth in our sponsorship and technology licensing businesses; our expectation that our cost of revenue-sharing will remain at current similar levels on a percentage of total revenue basis but increase modestly in absolute dollars; our expectation that our marketing and advertising expenses will increase in absolute dollars primarily due to an increase in online advertising and marketing opportunities; our expectation that our customer care and enrollment expenses will remain at a similar level on a percentage of total revenue basis and increase in absolute dollars; our expectation that technology and content expenses and general and administrative expenses as a percentage of total revenue will remain at similar levels but increase in absolute dollars and related factors impacting such increases; our expectation that interest and other income, net will decrease in absolute dollars and as a percentage of total revenue; the sufficiency of our cash, cash equivalents and marketable securities; future capital requirements; our intention to invest in a variety of instruments; future expenditures; factors on which our future growth will depend; our anticipation that our branding initiatives become increasingly difficult and expensive; changes to our ecommerce platform and other initiatives and the potential impact of such changes; growth of the individual and family health insurance market and factors contributing to such growth; factors affecting a softening of demand for our products and services, including as a result of changes in customer preferences or a weakening of the U.S. economy, and the related impact on our revenue and business; expansion of our Chinese operations and the additional management and resources required; expansion of our insurance platform in China to other geographic areas; as well as other statements regarding our future operations, financial condition, prospects and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under the heading "Risk Factors" in Part II, Item 1A of this report and those discussed in our other Securities and Exchange Commission filings. The following discussion should be read in conjunction with our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 17, 2008, and the audited consolidated financial statements and related notes contained therein. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements.*

**Overview**

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

Since our incorporation in November 1997, we have spent a significant amount on technology and content related to our ecommerce platform. We have also invested significant time and resources in obtaining licenses to sell health insurance in all 50 states and the District of Columbia, developing diverse and successful member acquisition programs and establishing relationships with over 180 leading insurance carriers, enabling us to offer thousands of health insurance products online. Our first online transaction relating to the sale of a health insurance policy was completed during the fourth quarter of 1998.



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

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

#### ***Revenue***

Commission revenue represented 93% and 94% of our total revenue for the three and nine months ended September 30, 2007, respectively, and 91% of our total revenue for the three and nine months ended September 30, 2008. The remainder of our revenue is primarily attributable to carrier sponsorship advertising on our website and licensing arrangements related to our technology. Our commission revenue has grown principally as a result of our penetration of the individual and family health insurance markets and corresponding growth in our membership. We estimate that as of September 30, 2008 we had approximately 602,100 members compared to the estimated 518,400 members we reported at December 31, 2007. We define a member as an individual covered by an insurance product for which we are entitled to receive compensation.

We believe our revenue and business have historically been more significantly affected by the rate of growth in the number of consumers using the Internet to research and purchase health insurance than by the rate at which the health insurance industry has grown. We expect that the rate of online adoption will continue to be a primary driver of our revenue.

Our commission revenue generally represents a percentage of the insurance premium a member has paid to his or her insurance carrier and, to a lesser extent, commission override payments that insurance carriers pay us for achieving sales volume thresholds or other objectives. Commission rates vary by carrier and by the type of plan purchased by a member. Commission rates also can vary based upon the amount of time that the policy has been active, with commission rates for individual and family policies typically being higher in the first twelve months of the policy. After the first twelve months, commission rates generally decline significantly. As a result, if we do not add a sufficient number of members on new policies, our revenue growth may be negatively impacted. Individuals, families and small businesses purchasing health insurance through us typically pay their premiums on a monthly basis. Insurance carriers typically pay us our commissions monthly, after they receive the premium payment from the member. We generally continue to receive the commission payment from the relevant insurance carrier until the health insurance policy is cancelled or we otherwise do not remain the agent on the policy. As a result, the majority of our revenue is recurring in nature and has grown in correlation with the growth we experience in our membership base.

We recognize commission revenue when our commission is reported to us by a health insurance carrier, net of an allowance for future forfeiture amounts payable to carriers due to policy cancellations. Commissions are reported to us by a cash payment and commission statement. We generally receive these communications simultaneously. In instances when we receive the cash payment and commission statement separately and in different accounting periods, we recognize revenue in the period that we receive the earliest communication, provided we receive the second communication corroborating the amount reported in the first communication within ten business days. If the second corroborating communication is not received within ten business days, we recognize revenue in the period the second communication is received. We use the data in the commission statement to identify the members for which we are receiving a commission payment and the amount received for each member, and to estimate our allowance for forfeitures. Commission override payments, which are recognized on the same basis as premium commissions, are generally reported to us in a more irregular pattern than premium commissions. As a result, our revenue for a particular quarter could be higher or lower than expectations due to the timing of the reporting of commission override payments.

Revenue attributable to individual and family product offerings represented approximately 85% of our commission revenue in the three and nine months ended September 30, 2007, and represented approximately 88% and 87% of our commission revenue in the three and nine months ended September 30, 2008, respectively. We define individual and family product offerings as major medical individual and family health insurance plans, which does not include small business, short-term major medical, stand-alone dental, life and student health insurance product offerings.

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In addition to the commission revenue we derive from the sale of health insurance products, we derive revenue from our online sponsorship advertising program and from licensing the use of our ecommerce technology. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. In return, we are typically paid a monthly fee, which is recognized over the period that advertising is displayed, and often a performance fee based on metrics such as submitted health insurance applications. Our technology licensing business allows carriers the use of our ecommerce platform to offer their own health insurance policies on their websites and agents to utilize our technology to power their online quoting, content and application submission processes. Typically, we are paid a one-time implementation fee, which we recognize on a straight-line basis over the estimated term of the customer relationship (generally the initial term of the agreement), commencing once the technology is available for use by the third party, and a performance fee based on metrics such as submitted health insurance applications. The metrics used to calculate performance fees for both sponsorship advertising and technology licensing are based on performance criteria that is either measured based on data that is tracked by us, or based on data that is tracked by the third party. In instances where the performance criteria data is tracked by us, we recognize revenue in the period of performance. In instances where the performance criteria data is tracked by the third party, we recognize revenue when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the third party along with a detailed statement containing the data that is tracked by the third party.

***Member Acquisition***

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

*Direct.* Our direct member acquisition channel consists of consumers who access our website addresses (*www.ehealth.com* and *www.ehealthinsurance.com*) either directly through algorithmic search listings on Internet search engines and directories or through direct links, such as links in news articles and email. Applications submitted through us for individual and family health insurance from our direct channel constituted approximately 40% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2007, and approximately 39% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2008.

*Marketing Partners.* Our marketing partner member acquisition channel consists of consumers who access our website through a network of affiliate partners and financial services and other companies. Growth in our marketing partner channel depends upon our expanding marketing programs with existing partners and adding new partners to our network. Applications submitted through us for individual and family health insurance products for which we paid fees to our marketing partner channel constituted approximately 31% and 30% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2007, respectively, and approximately 33% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2008.

*Online Advertising.* Our online advertising channel consists of consumers who access our website through paid keyword search advertising from search engines such as Google, MSN and Yahoo!, as well as various Internet marketing programs such as banner advertising, non-direct email marketing and an integrated partnership with MSN. Applications submitted through us for individual and family health insurance products from our online advertising channel constituted approximately 29% and 30% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2007, respectively, and approximately 28% of all individual and family health insurance applications submitted on our website for the three and nine months ended September 30, 2008.

**Operating Costs and Expenses*****Cost of Revenue-Sharing***

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

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***Marketing and Advertising***

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

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

Paid keyword search advertising on search engines represents the majority of expenses in our online advertising channel. We incur expenses associated with search engine advertising in the period in which the consumer clicks on the advertisement. We actively manage our paid keyword search advertising expense, taking into account the anticipated return from referrals. We also take into account the productivity and relative cost of paid keyword search as compared to other marketing channels and the anticipated lifetime revenue from members acquired, to control the amount of expense incurred during a given period.

We expect the average cost of acquiring new members to increase during the fourth quarter of 2008 compared to the third quarter ended September 30, 2008 primarily due to an increase in online advertising and marketing expenditures, including paid keyword search advertising. Our cost of acquisition depends significantly on the rate at which visitors to our website submit health insurance applications, particularly with respect to paid search advertising, as our paid search costs are incurred on the referral of a potential member rather than on the submission of a health insurance application. Other factors that may impact the average cost of acquiring new members include the mix of health insurance applications submitted through our three marketing channels, the mix of marketing partners referring consumers to our website, the overall trend in costs of online marketing, seasonality patterns, the amounts we pay marketing partners to refer consumers to our website, television and radio advertising expenditures, and an increase in compensation and benefit costs for marketing and advertising personnel. Additionally, we may explore new marketing initiatives that increase per member acquisition costs as part of our efforts to drive more consumers to our website.

Due to the departure of an executive officer in May 2007 who was not replaced, we reorganized the responsibilities of certain personnel in the second half of 2007. As a result, certain compensation, benefit and related expenses that were previously included in marketing and advertising and customer care and enrollment on our condensed consolidated statements of income were allocated to other functions starting in the second half of 2007 continuing through September 30, 2008. The net impact of the reorganization was to include an immaterial amount of compensation, benefit and related expense in our technology and content and general and administrative expenses during the three and nine months ended September 30, 2008, that would have remained as either marketing and advertising or customer care and enrollment expenses had the responsibilities of these personnel not changed.

**Table of Contents****Customer Care and Enrollment**

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

**Technology and Content**

Technology and content expenses consist primarily of compensation and related expenses for personnel associated with developing and enhancing our website technology as well as maintaining our website. A portion of our technology and content group is located at our wholly owned subsidiary in China, where technology development costs are generally lower than in the United States.

**General and Administrative**

General and administrative expenses include compensation and related expenses for staff working in our finance, legal, human resources, internal audit, facilities and internal information technology departments. These expenses also include fees paid for outside professional services, mainly for audit, tax, legal and information technology consulting.

**Summary of Selected Metrics**

The following table shows certain selected quarterly metrics as of September 30, 2007 and 2008 and for the three months ended September 30, 2007 and 2008 (unaudited):

|  | Three Months Ended<br>September 30, 2007 | Three Months Ended<br>September 30, 2008 |
|--|--|--|
| <b>Key Metrics:</b>  |  |  |
| Operating cash flows (1)   | \$ 7,711,000                             | \$ 8,257,000                             |
| IFP submitted applications (2)   | 97,900                                   | 117,300                                  |
| IFP approved members (3)   | 83,600                                   | 100,800                                  |
| Total approved members (4)   | 125,300                                  | 144,400                                  |
| Total revenue (5)  | \$ 22,997,000                            | \$ 28,475,000                            |
| Total revenue per estimated member for the period (6)  | \$ 48.16                                 | \$ 48.19                                 |
|  | As of                                    | As of                                    |
|  | September 30, 2007                       | September 30, 2008                       |
| IFP estimated membership (7)   | 408,100                                  | 506,100                                  |
| Total estimated membership (8)   | 491,300                                  | 602,100                                  |
|  | Three Months Ended                       | Three Months Ended                       |
|  | September 30, 2007                       | September 30, 2008                       |
| Marketing and advertising expenses (9)   | \$ 7,309,000                             | \$ 11,502,000                            |
| Marketing and advertising expenses as a percentage of total revenue (10)                         | 32%                                      | 40%                                      |
| <b>Other Metrics:</b>  |  |  |
| Source of IFP submitted applications (as a percentage of total IFP applications for the period): |  |  |
| Direct (11)  | 40%                                      | 39%                                      |
| Marketing partners (12)  | 31%                                      | 33%                                      |
| Online advertising (13)  | 29%                                      | 28%                                      |
| Total  | 100%                                     | 100%                                     |
| Acquisition cost per individual on IFP submitted applications (14)                               | \$ 49.07                                 | \$ 65.34                                 |



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**Notes:**

- (1) Net cash provided by operating activities for the period from the condensed consolidated statements of cash flows.
- (2) IFP applications submitted on eHealth's website during the period. Applications are counted as submitted when the applicant completes the application, provides a method for payment and clicks the submit button on our website and submits the application to us. The applicant generally has additional actions to take before the application will be reviewed by the insurance carrier, such as providing additional information and providing an electronic signature. In addition, an applicant may submit more than one application. We include applications for IFP products for which we receive commissions as well as other forms of payment. We define our IFP offerings as major medical individual and family health insurance plans, which does not include small business, short-term major medical, stand-alone dental, life or student health insurance product offerings.
- (3) New IFP members reported to eHealth as approved during the period. Some members that are approved by a carrier do not accept the approval and therefore do not become paying members.
- (4) New members for all products reported to eHealth as approved during the period. Some members that are approved by a carrier do not accept the approval and therefore do not become paying members.
- (5) Total revenue (from all sources) recognized during the period from the condensed consolidated statements of income.
- (6) Calculated as total revenue recognized during the period (see note (5) above) divided by average estimated membership for the period (calculated as beginning and ending estimated membership for all products for the period, divided by two).
- (7) Estimated number of members active on IFP insurance policies as of the date indicated. See discussion below for further information as to our methodology in estimating membership.
- (8) Estimated number of members active on all insurance policies as of the date indicated. See discussion below for further information as to our methodology in estimating membership.
- (9) Marketing and advertising expenses for the period from the condensed consolidated statements of income.
- (10) Calculated as marketing and advertising expenses for the period (see note (9) above) divided by total revenue for the period (see note (5) above).
- (11) Percentage of IFP submitted applications from applicants who came directly to the eHealth website through algorithmic search engine results or otherwise. See note (2) above for further information as to what constitutes a submitted application.
- (12) Percentage of IFP submitted applications from applicants sourced through eHealth's network of marketing partners. See note (2) above for further information as to what constitutes a submitted application.

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(13) Percentage of IFP submitted applications from applicants sourced through paid search and other online advertising activities. See note (2) above for further information as to what constitutes a submitted application.

(14) Calculated as marketing and advertising expenses for the period (see note (9) above) divided by the number of individuals on IFP applications submitted on eHealth's website during the period. This metric may not reflect the true acquisition cost.

Our insurance carrier partners bill and collect insurance premiums paid by our members. Carrier partners do not report to us the number of members that we have as of a given date. The majority of our members who terminate their policies do so by discontinuing their premium payments to the carrier and do not inform us of the cancellation. Also, some of our members pay their premiums less frequently than monthly. Given the number of months required to observe non-payment of commissions in order to confirm cancellations, we estimate the number of members who are active on insurance policies as of a specified date. We estimate the number of continuing members on non-small business insurance policies as of a specific date by taking the sum of (i) the number of members for whom we have received a commission payment for the month that is six months (or three months in the case of short-term, student and dental insurance) prior to the date of estimation (after reducing that number using historical experience for assumed member cancellations over the three-month or six-month period); and (ii) the number of approved members over the six-month period (or three months in the case of short-term, student and dental insurance) prior to the date of estimation (after reducing that number using historical experience for an assumed number of members who do not accept their approved policy and for estimated member cancellations through the date of the estimate). We estimate the number of small business group members using the number of initial members at the time the group is approved, and we update this number for changes in membership if such changes are reported to us by the group or carrier in the period it is reported. However, groups generally notify the carrier directly of policy cancellations and increases or decreases in group size without informing us. Additionally, our carrier partners often do not communicate this information to us. We often are made aware of policy cancellations at the time of annual renewal and update our membership statistics accordingly in the period they are reported.

After we have estimated membership for a period, we may receive information from health insurance carriers that would have impacted the estimate if we had received the information prior to the date of estimation. We may receive commission payments or other information that indicates that a member who was not included in our estimates for a prior period was in fact an active member at that time, or that a member who was included in our estimates was in fact not an

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active member of ours. For instance, we reconcile information carriers provide to us and may determine that we were not historically paid commissions owed to us, which would cause us to have underestimated our membership. Additionally, carriers may require us to return commission payments paid in a prior period due to policy cancellations for members we previously estimated as being active. We reflect updated information regarding our membership in the membership estimate for the current period that we are estimating, if applicable. As a result of the delay in our receipt of information from insurance carriers, actual trends in our membership are most discernable over periods longer than from one quarter to the next. In addition, and as a result of the delay we experience in receiving information about our membership, it is difficult for us to determine with any certainty the impact of current economic conditions on our membership retention. Based on information that we now possess, we experienced a slight increase in member turnover in the fourth quarter of 2007 and in the first quarter of 2008. At this time, however, we do not have enough information to determine whether economic conditions are currently impacting turnover in our membership base.

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

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

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

### ***Revenue Recognition***

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

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

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

Certain commission amounts are subject to forfeiture in circumstances where a member has prepaid his or her premium for a future period of coverage and subsequently cancels his or her policy before the completion of that period. We estimate and record an allowance for these forfeitures based on historical cancellation experience using data provided on commission statements. The forfeitures are typically reported to us by health insurance carriers one to two months after the commission





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is reported and paid to us by the carrier. Our estimate of the allowance for forfeitures includes an estimate of both the reporting time lag and the forfeiture amount. Changes in our historical trends would result in changes to our estimated forfeitures in future periods. There were no changes in our average forfeiture rates or reporting time lag during the three and nine months ended September 30, 2007 and 2008, which had a material impact on our allowance for forfeitures.

In addition to the commission revenue we derive from the sale of health insurance products, we derive revenue from our online sponsorship advertising program and from licensing the use of our ecommerce technology. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. In return, we are typically paid a monthly fee, which is recognized over the period that advertising is displayed, and often a performance fee based on metrics such as submitted health insurance applications. Our technology licensing business allows carriers the use of our ecommerce platform to offer their own health insurance policies on their websites and agents to utilize our technology to power their online quoting, content and application submission processes. Typically, we are paid a one-time implementation fee, which we recognize on a straight-line basis over the estimated term of the customer relationship (generally the initial term of the agreement), commencing once the technology is available for use by the third party, and a performance fee based on metrics such as submitted health insurance applications. The metrics used to calculate performance fees for both sponsorship advertising and technology licensing are based on performance criteria that is either measured based on data that is tracked by us, or based on data that is tracked by the third party. In instances where the performance criteria data is tracked by us, we recognize revenue in the period of performance. In instances where the performance criteria data is tracked by the third party, we recognize revenue when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the third party along with a detailed statement containing the data that is tracked by the third party.

Deferred revenue consists of deferred technology licensing implementation fees as well as amounts collected from sponsorship or technology licensing customers in advance of our performing our service for such customers. We also defer amounts that have been reported to us related to transactions where our services are complete, but where we cannot currently estimate the allowance for future forfeitures related to those amounts.

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

We account for internal-use software and website development costs in accordance with the guidance set forth in Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, and EITF Issue No. 00-02, *Accounting for Web Site Development Costs*. We capitalize costs of materials, consultants and compensation and related expenses of employees who devote time to the development of internal-use software; however, we usually expense as incurred website development costs for new features and functionalities because it is not probable that they will result in additional functionality until they are both developed and tested with confirmation that they are more effective than the current set of features and functionalities on our website. Our judgment is required in determining the point at which various projects enter the states at which costs may be capitalized, in assessing the ongoing value of the capitalized costs and in determining the estimated useful lives over which the costs are amortized, which is generally three years. To the extent that we change the manner in which we develop and test new features and functionalities related to our website, assess the ongoing value of capitalized assets or determine the estimated useful lives over which the costs are amortized, the amount of website development costs we capitalize and amortize in future periods would be impacted.

***Stock-Based Compensation***

We account for stock-based compensation expense pursuant to the provisions of SFAS No. 123R ( SFAS 123R ), *Share-Based Payment*, which requires that all share-based payments, including grants of employee stock options, be recognized as an expense in the accompanying condensed consolidated statements of income and comprehensive income based on their fair value over the vesting period, which is generally four years. The grant date fair value of our stock-based awards was determined using the Black-Scholes-Merton pricing model and a single option award approach. The weighted-average expected term for stock options granted was calculated using the simplified method in accordance with the provisions of SAB No. 107, *Share-Based Payment*, as we did not have sufficient historical option exercise behavior on which to estimate expected terms. The simplified method defines the expected term as the average of the contractual term and the vesting period of the stock option. We have estimated the volatility used as an input to the model based on an analysis of our stock price since our initial public offering in October 2006, as well as an analysis of similar public companies for which we have data. We estimate our expected volatility using the weighted-average of: our implied volatility; our mean reversion volatility; and the mean reversion volatility of similar public companies for which we have data. We have used judgment in selecting these companies, as well as evaluating the available historical and implied volatility data for these 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



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management judgment. We will continue to use judgment in evaluating the expected term and volatility related to our own stock-based awards on a prospective basis, and incorporating these factors into the model. Changes in key assumptions will significantly impact the valuation of such instruments.

We recorded stock-based compensation expense totaling \$0.4 million and \$1.0 million during the three and nine months ended September 30, 2007, respectively, and \$1.0 million and \$2.6 million during the three and nine months ended September 30, 2008, respectively, related to stock options, restricted stock awards and restricted stock units granted to employees. Future stock-based compensation expense is dependent upon the fair value of each option at the date each option is granted and the number of awards issued and outstanding during each period. We expect stock-based compensation expense will increase in the future as the number of equity awards issued and outstanding increases.

### *Accounting for Income Taxes*

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

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

Management judgment is required in determining any valuation allowance recorded against our net deferred tax assets. In the fourth quarter of 2007, we were able to develop expectations of future taxable income and estimate other relevant factors sufficiently in the future to conclude that it was more likely than not that we will realize sufficient earnings to utilize all of our deferred tax assets. Accordingly, we reversed our valuation allowance against deferred tax assets in the fourth quarter of 2007.

As part of the process of preparing our condensed consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our actual current tax expense together with assessing temporary differences that may result in deferred tax assets, as well as discrete tax items during the period, such as excess tax benefits related to share-based payments. Our effective tax rates in the three and nine months ended September 30, 2007 and 2008 were in line with statutory federal and state tax rates in those periods.

On September 23, 2008, the state of California approved its budget for fiscal year ending June 30, 2009, which contained changes to the California tax law which substantially limit our ability to utilize available state net operating loss and tax credit carry forwards to reduce our state income taxes payable. Under the new tax law, the utilization of net operating loss carry forwards is suspended for tax years 2008 and 2009; however the expiration date of the net operating loss carry forwards is extended for an equivalent two-year period. Additionally, for tax years 2008 and 2009, taxpayers may only utilize available tax credit carry forwards to reduce their current tax liability up to 50% of their net tax amount before application of such credits. The new law does not affect the amount of net operating loss or tax credit carry forwards that we expect to ultimately use to offset future California taxes; however, it does limit the amount of net operating loss and tax credit carry forwards that we will be able to utilize to reduce our taxes payable during the years ending December 31, 2008 and 2009, resulting in an increase in cash taxes payable to the state of California in those years. While we do not expect this change in the California tax law to impact our effective tax rate, we expect that our cash outlay for federal and state taxes will increase to approximately 4.5% of pre-tax income for the year ending December 31, 2008.

Under SFAS 123R, we consider stock option deduction benefits in excess of book compensation charges realized when we obtain an incremental benefit determined by the With and Without calculation method. Under the With and Without approach, excess tax benefits related to share-based payments are not deemed to be realized until after the utilization of all other tax benefits available to us. For example, net operating loss and tax credit carry forwards from prior years are used to reduce taxes currently payable prior to deductions from stock option exercises for purposes of financial reporting, while for tax return purposes, current year stock compensation deductions are generally used before net operating loss carry forwards.



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Indirect effects of excess tax benefits, such as the effect on research and development tax credits, are not considered. In accordance with SFAS 123R, only realized excess tax benefits are reflected in the financial statements.

During the three months ended September 30, 2008, due to the restriction on our ability to utilize net operating loss carry forwards to reduce taxes currently payable in California, we utilized excess tax benefits related to share-based payments and other unrecognized tax benefits, which resulted in a \$0.2 million increase in additional paid-in capital and a \$0.3 million increase in other non-current liabilities, respectively, in the condensed consolidated balance sheet as of September 30, 2008. We expect to continue utilizing excess tax benefits related to share-based payments and other unrecognized tax benefits in the fourth quarter of 2008 and fiscal year 2009, which will result in further increases to additional paid-in capital and other non-current liabilities during those periods.

Future changes in various factors, such as the amount of stock-based compensation we record during the year and the related tax benefit we realize upon the exercise of employee stock options, potential limitations on the use of our federal and state net operating loss credit carry forwards, pending or future tax law changes including rate changes and the tax benefit from or limitations on our ability to utilize research and development credits, changes in our valuation allowance and state and foreign taxes, would impact our estimates, and as a result, could affect our effective tax rate and the amount of income tax expense we record, and pay, in future periods.

We adopted the provisions of FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, on January 1, 2007. As of December 31, 2007 and September 30, 2008, we had approximately \$2.4 million and \$2.6 million, respectively, of unrecognized tax benefits. As of December 31, 2007 and September 30, 2008, there were \$2.0 million and \$2.1 million, respectively, of unrecognized tax benefits, that, if recognized, would impact the effective tax rate. Due to net operating losses, all tax years after 1998 are open to examination and adjustment.

On October 3, 2008, the *Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008 and Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (HRI424)* was signed into law, which, as enacted, includes a provision that retroactively extends the federal research and development tax credit from January 1, 2008 through December 31, 2009. Federal research and development tax credits for the year ending December 31, 2008, which are not expected to be material, will be included in our provision for income taxes for the three months ending December 31, 2008.

**Fair Value Measurements**

We implemented Statement of Financial Accounting Standard No. 157 ( SFAS 157 ), *Fair Value Measurement*, effective January 1, 2008 for our financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. In accordance with the provisions of FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, we have elected to defer until January 1, 2009, implementation of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized and disclosed at fair value in the consolidated financial statements on a recurring basis. The partial adoption of SFAS 157 did not have a material impact on our consolidated financial position, results of operations or cash flows.

SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. SFAS 157 classifies the inputs used to measure fair value into the following hierarchy:

- Level 1     Unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2     Unadjusted quoted prices in active markets for similar assets or liabilities, or  
Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or  
Inputs other than quoted prices that are observable for the asset or liability
- Level 3     Unobservable inputs for the asset or liability

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We endeavor to utilize the best available information in measuring fair value of our assets, and as such, use market data or assumptions that we believe market participants would use in pricing an asset or liability. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. We have determined that our financial assets are classified as either Level 1 or Level 2 in the fair value hierarchy as of September 30, 2008. The adoption of SFAS 157 did not have a material impact on our consolidated results of operations and financial condition.

In October 2008, the FASB issued Staff Position (FSP) No. FAS 157-3 (FSP 157-3), *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, which clarifies the application of Statement No. 157 in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active.

During the three and nine months ended September 30, 2008, we incurred net unrealized losses on our marketable securities of \$0.4 million and \$0.5 million, respectively. Net unrealized gains and losses incurred on our marketable securities during the three and nine months ended September 30, 2007 were not significant. Net unrealized losses are the result of the change in fair value of our investments in marketable securities, primarily corporate bonds, at the beginning and end of the period. As we do not consider our investments to be other-than-temporarily impaired at September 30, 2008, the unrealized losses are excluded from earnings and reported as a component of stockholders' equity in the condensed consolidated balance sheets and in comprehensive income on the condensed consolidated statements of income and comprehensive income. We did not realize any significant gains or losses on sales of marketable securities during the three and nine months ended September 30, 2007 and 2008.

**Results of Operations**

The following table sets forth our operating results and the related percentage of total revenues for the three and nine months ended September 30, 2007 and 2008 (dollars in thousands, unaudited):

|                                      | Three Months Ended September 30, |     |           |     | Nine Months Ended September 30, |     |           |     |
|--------------------------------------|----------------------------------|-----|-----------|-----|---------------------------------|-----|-----------|-----|
|                                      | 2007                             |     | 2008      |     | 2007                            |     | 2008      |     |
| <b>Revenue:</b>                      |                                  |     |           |     |                                 |     |           |     |
| Commission                           | \$ 21,313                        | 93% | \$ 25,788 | 91% | \$ 59,486                       | 94% | \$ 74,663 | 91% |
| Sponsorship, licensing and other     | 1,684                            | 7   | 2,687     | 9   | 4,072                           | 6   | 7,593     | 9   |
| Total revenue                        | 22,997                           | 100 | 28,475    | 100 | 63,558                          | 100 | 82,256    | 100 |
| <b>Operating costs and expenses:</b> |                                  |     |           |     |                                 |     |           |     |
| Cost of revenue-sharing              | 427                              | 2   | 469       | 2   | 1,245                           | 2   | 1,338     | 2   |
| Marketing and advertising            | 7,309                            | 32  | 11,502    | 40  | 21,021                          | 33  | 30,633    | 37  |
| Customer care and enrollment         | 3,002                            | 13  | 3,722     | 13  | 8,859                           | 14  | 10,655    | 13  |
| Technology and content               | 3,108                            | 13  | 3,565     | 12  | 9,025                           | 14  | 10,548    | 13  |
| General and administrative           | 4,308                            | 19  | 4,731     | 17  | 11,698                          | 19  | 13,475    | 16  |
| Total operating costs and expenses   | 18,154                           | 79  | 23,989    | 84  | 51,848                          | 82  | 66,649    | 81  |
| Income from operations               | 4,843                            | 21  | 4,486     | 16  | 11,710                          | 18  | 15,607    | 19  |
| Interest and other income, net       | 1,403                            | 6   | 935       | 3   | 3,849                           | 6   | 3,085     | 4   |
| Income before income taxes           | 6,246                            | 27  | 5,421     | 19  | 15,559                          | 24  | 18,692    | 23  |
| Provision for income taxes           | 2,516                            | 11  | 2,400     | 8   | 6,324                           | 10  | 8,173     | 10  |
| Net income                           | \$ 3,730                         | 16% | \$ 3,021  | 11% | \$ 9,235                        | 14% | \$ 10,519 | 13% |

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

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|                              | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                 |
|------------------------------|-------------------------------------|---------------|------------------------------------|-----------------|
|                              | 2007                                | 2008          | 2007                               | 2008            |
| Marketing and advertising    | \$ 45                               | \$ 151        | \$ 113                             | \$ 484          |
| Customer care and enrollment | 30                                  | 49            | 86                                 | 200             |
| Technology and content       | 143                                 | 203           | 416                                | 653             |
| General and administrative   | 132                                 | 552           | 347                                | 1,272           |
| <b>Total</b>                 | <b>\$ 350</b>                       | <b>\$ 955</b> | <b>\$ 962</b>                      | <b>\$ 2,609</b> |



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The following table presents our commission, sponsorship, licensing and other and total revenue and the absolute dollar and percentage changes from the comparable prior year periods (dollars in thousands, unaudited):

|                                  | Three Months Ended<br>September 30, |           | Change   |     | Nine Months Ended<br>September 30, |           | Change    |     |
|----------------------------------|-------------------------------------|-----------|----------|-----|------------------------------------|-----------|-----------|-----|
|                                  | 2007                                | 2008      | \$       | %   | 2007                               | 2008      | \$        | %   |
| Commission                       | \$ 21,313                           | \$ 25,788 | \$ 4,475 | 21% | \$ 59,486                          | \$ 74,663 | \$ 15,177 | 26% |
| Percentage of total revenue      | 93%                                 | 91%       |          |     | 94%                                | 91%       |           |     |
| Sponsorship, licensing and other | \$ 1,684                            | \$ 2,687  | \$ 1,003 | 60% | \$ 4,072                           | \$ 7,593  | \$ 3,521  | 86% |
| Percentage of total revenue      | 7%                                  | 9%        |          |     | 6%                                 | 9%        |           |     |
| Total revenue                    | \$ 22,997                           | \$ 28,475 | \$ 5,478 | 24% | \$ 63,558                          | \$ 82,256 | \$ 18,698 | 29% |

**Three Months Ended September 30, 2008 and 2007** Total revenue increased \$5.5 million, or 24%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to an increase in commission revenue as a result of an aggregate increase in our membership. Our estimated membership increased approximately 25% to 602,100 at September 30, 2008 from 491,300 at September 30, 2007. Sponsorship, licensing and other revenue increased \$1.0 million, or 60%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to the sale of additional carrier sponsorship advertising on our website and new licensing arrangements related to our technology.

**Nine Months Ended September 30, 2008 and 2007** Total revenue increased \$18.7 million, or 29%, in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to an increase in commission revenue as a result of an aggregate increase in our membership, as well as an increase in commission overrides earned by us. Sponsorship, licensing and other revenue increased \$3.5 million, or 86%, in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to the sale of additional carrier sponsorship advertising on our website and new licensing arrangements related to our technology. In addition, sponsorship, licensing and other revenue for the nine months ended September 30, 2008 included the recognition of \$0.5 million of revenue relating to a one-time, non-recurring item.

Revenue for all periods presented was generated from customers located solely in the United States. The following carriers (or carriers owned by them) represented 10% or more of our total revenue for the three and nine months ended September 30, 2007 and 2008 (unaudited):

|                  | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|------------------|-------------------------------------|------|------------------------------------|------|
|                  | 2007                                | 2008 | 2007                               | 2008 |
| UnitedHealthcare | 18%                                 | 17%  | 19%                                | 17%  |
| Wellpoint        | 17%                                 | 16%  | 18%                                | 16%  |
| Aetna            | 12%                                 | 14%  | 11%                                | 13%  |

Based on information currently available to us, we expect total revenue to increase in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 as a result of continued growth in our membership base and growth in our sponsorship and technology licensing businesses.

**Table of Contents****Operating Costs and Expenses****Cost of Revenue-Sharing**

The following table presents our cost of revenue-sharing and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                             | Three Months Ended |                    | Change |     | Nine Months Ended  |                    | Change |    |
|-----------------------------|--------------------|--------------------|--------|-----|--------------------|--------------------|--------|----|
|                             | September 30, 2007 | September 30, 2008 | \$     | %   | September 30, 2007 | September 30, 2008 | \$     | %  |
| Cost of revenue-sharing     | \$ 427             | \$ 469             | \$ 42  | 10% | \$ 1,245           | \$ 1,338           | \$ 93  | 7% |
| Percentage of total revenue | 2%                 | 2%                 |        |     | 2%                 | 2%                 |        |    |

**Three Months Ended September 30, 2008 and 2007** Cost of revenue-sharing increased 10% in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to an increase in the number of health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. As a percentage of total revenue, cost of revenue-sharing remained consistent at 2% in both three-month periods ended September 30, 2007 and 2008.

**Nine Months Ended September 30, 2008 and 2007** Cost of revenue-sharing increased 7% in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to an increase in the number of health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. As a percentage of total revenue, cost of revenue-sharing remained consistent at 2% in both nine-month periods ended September 30, 2007 and 2008.

Although we expect our cost of revenue-sharing to remain at a similar level in the fourth quarter of 2008 compared to the third quarter of 2008 on a percentage of total revenue basis, we expect cost of revenue-sharing to increase modestly in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 as a result of an increase in commission revenue related to health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements.

**Marketing and Advertising**

The following table presents our marketing and advertising expenses and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                             | Three Months Ended |                    | Change   |     | Nine Months Ended  |                    | Change   |     |
|-----------------------------|--------------------|--------------------|----------|-----|--------------------|--------------------|----------|-----|
|                             | September 30, 2007 | September 30, 2008 | \$       | %   | September 30, 2007 | September 30, 2008 | \$       | %   |
| Marketing and advertising   | \$ 7,309           | \$ 11,502          | \$ 4,193 | 57% | \$ 21,021          | \$ 30,633          | \$ 9,612 | 46% |
| Percentage of total revenue | 32%                | 40%                |          |     | 33%                | 37%                |          |     |

**Three Months Ended September 30, 2008 and 2007** Marketing and advertising expenses increased by \$4.2 million, or 57%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007. This was primarily due to a \$2.1 million increase in online advertising expenses from an increase in paid keyword search advertising costs on Internet search engines associated with an increase in both the volume and cost of click-throughs from the online advertising channel, and a \$0.6 million increase in television and radio advertising expenses. Marketing partner expenses increased \$1.1 million primarily due to the growth in the number of applications submitted on our website through the marketing partner channel and an increase in the cost per submitted application during the three months ended September 30, 2008 compared to the three months ended September 30, 2007. Our acquisition cost per member, if measured as total marketing and advertising expenses for a period divided by the number of individuals included on applications for individual and family product offerings submitted during the period, increased 33% to \$65.34 in the three months ended September 30, 2008 from \$49.07 in the three months ended September 30, 2007 primarily due to the increases in online advertising and marketing partner channel expenses. As a percentage of total revenue, total marketing and advertising expenses increased to 40% in the three months ended September 30, 2008 from 32% in the three months ended September 30, 2007.



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**Nine Months Ended September 30, 2008 and 2007** Marketing and advertising expenses increased by \$9.6 million, or 46%, in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. This was primarily due to a \$4.9 million increase in online advertising expenses from an increase in paid keyword search advertising costs on Internet search engines associated with an increase in both the volume and cost of click-throughs from the online advertising channel, and an increase in television and radio advertising expenses of \$1.0 million. Marketing partner expenses increased \$3.2 million primarily due to the growth in the number of applications submitted on our website through the marketing partner channel and an increase in the cost per submitted application during the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. In addition, compensation and benefit costs increased \$0.5 million associated with an increase in marketing and advertising personnel. As a percentage of total revenue, total marketing and advertising expenses increased to 37% in the nine months ended September 30, 2008 from 33% in the nine months ended September 30, 2007.

We expect our marketing and advertising expenses to increase in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 primarily due to an increase in online advertising and marketing expenditures, including paid keyword search advertising. As a result, we expect the average cost of acquiring new members to increase in the fourth quarter of 2008 compared to the third quarter of 2008. Our cost of acquisition depends significantly on the rate at which visitors to our website submit health insurance applications, particularly with respect to paid search advertising as our paid search costs are incurred on the referral of a potential member rather than on the submission of a health insurance application. Other factors that may impact the average cost of acquiring new members include the mix of health insurance applications submitted through our three marketing channels, the mix of marketing partners referring consumers to our website, the overall trend in costs of online marketing, seasonality patterns, the amounts we pay marketing partners to refer consumers to our website, television and radio advertising expenditures, and an increase in compensation and benefit costs for marketing and advertising personnel. Additionally, we may explore new marketing initiatives that increase per member acquisition costs as part of our efforts to drive more consumers to our website.

**Customer Care and Enrollment**

The following table presents our customer care and enrollment expenses and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                              | Three Months Ended |                    | Change |     | Nine Months Ended  |                    | Change   |     |
|------------------------------|--------------------|--------------------|--------|-----|--------------------|--------------------|----------|-----|
|                              | September 30, 2007 | September 30, 2008 | \$     | %   | September 30, 2007 | September 30, 2008 | \$       | %   |
| Customer care and enrollment | \$ 3,002           | \$ 3,722           | \$ 720 | 24% | \$ 8,859           | \$ 10,655          | \$ 1,796 | 20% |
| Percentage of total revenue  | 13%                | 13%                |        |     | 14%                | 13%                |          |     |

**Three Months Ended September 30, 2008 and 2007** Customer care and enrollment expenses increased by \$0.7 million, or 24%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to an increase in compensation and benefit costs associated with an increase in personnel servicing health insurance applications submitted through our website. As a percentage of total revenue, customer care and enrollment expenses remained at 13% in the three months ended September 30, 2007 and 2008.

**Nine Months Ended September 30, 2008 and 2007** Customer care and enrollment expenses increased by \$1.8 million, or 20%, in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to an increase in compensation and benefit costs associated with an increase in personnel servicing health insurance applications submitted through our website. As a percentage of total revenue, customer care and enrollment expenses decreased to 13% in the nine months ended September 30, 2008 from 14% in the nine months ended September 30, 2007 as we leveraged the operational efficiencies of our customer care and enrollment operations.

Although we expect our customer care and enrollment expenses to remain at a similar level in the fourth quarter of 2008 compared to the third quarter of 2008 on a percentage of total revenue basis, we expect customer care and enrollment expenses to increase in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 as we hire additional personnel to service the growth in health insurance applications submitted through our website.

**Table of Contents****Technology and Content**

The following table presents our technology and content expenses and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                             | Three Months Ended |                    | Change |     | Nine Months Ended  |                    | Change   |     |
|-----------------------------|--------------------|--------------------|--------|-----|--------------------|--------------------|----------|-----|
|                             | September 30, 2007 | September 30, 2008 | \$     | %   | September 30, 2007 | September 30, 2008 | \$       | %   |
| Technology and content      | \$ 3,108           | \$ 3,565           | \$ 457 | 15% | \$ 9,025           | \$ 10,548          | \$ 1,523 | 17% |
| Percentage of total revenue | 13%                | 12%                |        |     | 14%                | 13%                |          |     |

**Three Months Ended September 30, 2008 and 2007** Technology and content expenses increased by \$0.5 million, or 15%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to an increase compensation and benefit costs associated with an increase in technology and content personnel and an increase in data center costs associated with maintaining our computer hardware and software. As a percentage of total revenue, technology and content costs decreased to 12% in the three months ended September 30, 2008 from 13% in the three months ended September 30, 2007 primarily as a result of economies of scale achieved by our technology and content operations.

**Nine Months Ended September 30, 2008 and 2007** Technology and content expenses increased by \$1.5 million, or 17%, in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to an increase compensation and benefit costs of \$0.4 million associated with an increase in technology and content personnel. Additionally, data center costs increased \$0.3 million associated with maintaining our computer hardware and software. As a percentage of total revenue, technology and content costs decreased to 13% in the nine months ended September 30, 2008 from 14% in the nine months ended September 30, 2007 primarily as a result of economies of scale achieved by our technology and content operations.

Although we expect our technology and content expenses to remain at a similar level in the fourth quarter of 2008 compared to the third quarter of 2008 on a percentage of total revenue basis, we expect technology and content expenses to increase in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 due to our continued focus on technology development, including the enhancement of our ecommerce platform.

**General and Administrative**

The following table presents our general and administrative expenses and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                             | Three Months Ended |                    | Change |     | Nine Months Ended  |                    | Change   |     |
|-----------------------------|--------------------|--------------------|--------|-----|--------------------|--------------------|----------|-----|
|                             | September 30, 2007 | September 30, 2008 | \$     | %   | September 30, 2007 | September 30, 2008 | \$       | %   |
| General and administrative  | \$ 4,308           | \$ 4,731           | \$ 423 | 10% | \$ 11,698          | \$ 13,475          | \$ 1,777 | 15% |
| Percentage of total revenue | 19%                | 17%                |        |     | 19%                | 16%                |          |     |

**Three Months Ended September 30, 2008 and 2007** General and administrative expenses increased by \$0.4 million, or 10%, in the three months September 30, 2008 compared to the three months ended September 30, 2007 primarily due to an increase in stock-based compensation costs of \$0.4 million related to additional equity grants to our general and administrative employees in the first quarter of 2008. As a percentage of total revenue, general and administrative expenses decreased to 17% in the three months ended September 30, 2008 from 19% in the three months ended September 30, 2007 primarily as a result of economies of scale achieved by our general and administrative operations.

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**Nine Months Ended September 30, 2008 and 2007** General and administrative expenses increased by \$1.8 million, or 15%, in the nine months September 30, 2008 compared to the nine months ended September 30, 2007 primarily due to an increase in compensation and benefit costs of \$1.2 million associated with increased personnel in our finance and legal departments and an increase in stock-based compensation costs of \$0.9 million related to additional equity grants to our general and administrative employees in the first quarter of 2008. Partially offsetting these increases was a decrease of \$0.7 million in outside accounting and legal fees. As a percentage of total revenue, general and administrative expenses decreased to 16% in the nine months ended September 30, 2008 from 19% in the nine months ended September 30, 2007 primarily as a result of economies of scale achieved by our general and administrative operations.

Although we expect our general and administrative expenses to remain at a similar level in the fourth quarter of 2008 compared to the third quarter of 2008 on a percentage of total revenue basis, we expect our general and administrative expenses to continue to increase in absolute dollars in the fourth quarter of 2008 compared to the third quarter of 2008 due to the increased costs necessary to support the growth in our business.

**Interest and Other Income, Net**

The following table presents our interest and other income, net, and the absolute dollar and percentage change from the comparable prior year periods (dollars in thousands, unaudited):

|                                | Three Months Ended |                    | Change   |       | Nine Months Ended  |                    | Change   |       |
|--------------------------------|--------------------|--------------------|----------|-------|--------------------|--------------------|----------|-------|
|                                | September 30, 2007 | September 30, 2008 | \$       | %     | September 30, 2007 | September 30, 2008 | \$       | %     |
| Interest and other income, net | \$ 1,403           | \$ 935             | \$ (468) | (33)% | \$ 3,849           | \$ 3,085           | \$ (764) | (20)% |
| Percentage of total revenue    | 6%                 | 3%                 |          |       | 6%                 | 4%                 |          |       |

Interest and other income, net, primarily consists of interest income earned on our invested cash, cash equivalent and marketable securities balances, offset by administrative bank fees, investment management fees and interest expense on our capital lease obligations.

**Three and Nine Months Ended September 30, 2008 and 2007** Interest and other income, net, decreased 33% and 20% in the three and nine months ended September 30, 2008 compared to the three and nine months ended September 30, 2007, respectively. These decreases were primarily due to declines in the average yield earned on our invested cash, cash equivalents and marketable securities during the three and nine months ended September 30, 2008. Cash, cash equivalents and marketable securities increased from \$112.7 million at September 30, 2007 to \$143.3 million at September 30, 2008 primarily from cash generated from operations and net proceeds from the exercise of common stock options.

We expect interest and other income, net, to decline in absolute dollars, as well as a percentage of total revenue, in the fourth quarter of 2008 compared to the third quarter of 2008 as a result of a continued decline in the average yield we earn on our invested cash, cash equivalents and marketable securities.

**Provision for Income Taxes**

The following table presents our provision for income taxes and the absolute dollar change from the comparable prior year periods (dollars in thousands, unaudited):

|                             | Three Months Ended |                    | Change   |      | Nine Months Ended  |                    | Change   |     |
|-----------------------------|--------------------|--------------------|----------|------|--------------------|--------------------|----------|-----|
|                             | September 30, 2007 | September 30, 2008 | \$       | %    | September 30, 2007 | September 30, 2008 | \$       | %   |
| Provision for income taxes  | \$ 2,516           | \$ 2,400           | \$ (116) | (5)% | \$ 6,324           | \$ 8,173           | \$ 1,849 | 29% |
| Percentage of total revenue | 11%                | 8%                 |          |      | 10%                | 10%                |          |     |

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**Three and Nine Months Ended September 30, 2008 and 2007** During the three and nine months ended September 30, 2008, we recorded a provision for income taxes of \$2.4 million and \$8.2 million, respectively, representing an effective tax rate of approximately 44%. During the three and nine months ended September 30, 2007, we recorded a provision for income taxes of \$2.5 million and \$6.3 million, respectively, representing an effective tax rate of approximately 41%. Due to the large amount of net operating loss and tax credit carry forwards available at December 31, 2007, we expect to pay federal and state taxes in 2008 on a cash basis of approximately 4.5% of pre-tax income. Our deferred tax assets were reduced during the three and nine months ended September 30, 2008 compared to December 31, 2007 due to the utilization of net operating loss and tax credit carry forwards against taxable income in those periods. In addition, additional paid-in capital and other non-current liabilities increased during the third quarter of 2008 due to the utilization of excess tax benefits related to share-based payments and other unrecognized tax benefits, respectively. We expect to continue utilizing excess tax benefits related to share-based payments and other unrecognized tax benefits in the fourth quarter of 2008 and fiscal year 2009, which will result in further increases to additional paid-in capital and other non-current liabilities during those periods.

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

**Liquidity and Capital Resources**

The following table presents a summary of our cash flows for the nine months ended September 30, 2007 and 2008 (in thousands, unaudited):

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2007</b>                                | <b>2008</b> |
| Net cash provided by operating activities | \$ 18,282                                  | \$ 22,750   |
| Net cash used in investing activities     | \$ (34,815)                                | \$ (15,308) |
| Net cash provided by financing activities | \$ 4,879                                   | \$ 1,642    |

At September 30, 2008, our cash, cash equivalents and marketable securities totaled \$143.3 million. Cash equivalents are comprised primarily of highly liquid financial instruments with an original maturity of 90 days or less from the date of purchase, and marketable securities are comprised primarily of highly liquid available-for-sale financial instruments with original maturities of more than 90 days but less than two years from the date of purchase. Marketable securities that are available for use in current operations are classified as current assets in the accompanying condensed consolidated balance sheets regardless of the remaining time to maturity.

Our capital expenditures for the three and nine months ended September 30, 2008 were \$0.9 million and \$2.2 million, respectively. Capital expenditures in the third quarter of 2008 were impacted by a one-time project relating to the expansion of our data center operations. Currently, we expect our full year capital expenditures to be in the \$3 million to \$4 million range.

**Operating Activities**

Cash provided by operating activities primarily consists of net income, adjusted for certain non-cash items including deferred income taxes, depreciation and amortization, stock-based compensation and the effect of changes in working capital and other activities.

**Nine Months Ended September 30, 2008** Our operating activities generated cash of \$22.8 million during the nine months ended September 30, 2008 primarily due to \$10.5 million of net income, \$7.1 million of deferred income tax, \$2.6 million in non-cash stock-based compensation expense, \$1.3 million in non-cash depreciation and amortization expenses, a \$1.5 million increase in accrued marketing expenses and a \$0.5 million decrease in prepaid expenses and other current assets. These items were partially offset by a \$0.7 million decrease in accrued compensation and benefits primarily due to timing of compensation and benefit payments and \$0.2 million of realized excess tax benefits related to share-based payments classified as an operating cash outflow.

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**Nine Months Ended September 30, 2007** Our operating activities generated cash of \$18.3 million during the nine months ended September 30, 2007, primarily due to \$9.2 million of net income, \$6.1 million of deferred income tax, \$1.3 million of non-cash depreciation and amortization expenses, \$1.0 million of non-cash stock-based compensation expense, a \$0.8 million increase in accrued marketing expenses and a \$0.8 million increase in other current liabilities. These items were partially offset by a \$0.5 million increase in other assets.

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

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

***Investing Activities***

Our investing activities primarily consist of purchases, sales and maturities of marketable securities and capital expenditures for property and equipment associated with computer hardware and software to enhance our website and to support our growth. Marketable securities generally consist of highly liquid, investment grade corporate and U.S. government-sponsored enterprise debt securities, commercial paper and certificates of deposit that have a maturity of more than 90 days but less than two years from the date of purchase and are available for use in current operations. These investments are carried at fair value with unrealized gains and losses, net of taxes, reported as a component of stockholders equity in the condensed consolidated balance sheets and in comprehensive income on the condensed consolidated statements of income and comprehensive income

During the three and nine months ended September 30, 2008, we incurred net unrealized losses on our marketable securities of \$0.4 million and \$0.5 million, respectively. Net unrealized gains and losses incurred on our marketable securities during the three and nine months ended September 30, 2007 were not significant. Net unrealized losses are the result of the change in fair value of our investments in marketable securities, primarily corporate bonds, at the beginning and end of the period. We did not realize any significant gains or losses on sales of marketable securities during the three and nine months ended September 30, 2007 and 2008.

At September 30, 2008, we evaluated each of our unrealized losses, the majority of which are from corporate bonds, and determined them to be temporary in accordance with Emerging Issues Task Force ( EITF ) Abstract No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. Factors we considered in determining whether unrealized losses were temporary included the length of time and extent to which each investment's fair value has been less than its cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Based upon our evaluation of these factors, and because we have the ability and intent to hold each of our investments with net unrealized losses until their respective maturity dates, we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

**Nine Months Ended September 30, 2008** Net cash used by investing activities of \$15.3 million during the nine months ended September 30, 2008 was primarily attributable to purchases of short-term marketable securities of \$61.6 million and capital expenditures of \$2.2 million, partially offset by maturities and sales of short-term marketable securities of \$38.4 million and \$10.1 million, respectively.

**Nine Months Ended September 30, 2007** Net cash used by investing activities of \$34.8 million during the nine months ended September 30, 2007 was primarily attributable to purchases of short-term marketable securities of \$36.5 million and capital expenditures of \$1.1 million, partially offset by sales and maturities of short-term marketable securities of \$2.2 million and \$0.6 million, respectively.



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### ***Financing Activities***

***Nine Months Ended September 30, 2008*** Cash provided by financing activities of \$1.6 million during the nine months ended September 30, 2008 was primarily due to net proceeds of \$1.4 million received from the issuance of common stock pursuant to stock option exercises and \$0.2 million of realized excess tax benefits related to share-based payments classified as a financing cash inflow.

***Nine Months Ended September 30, 2007*** Net cash provided by financing activities of \$4.9 million during the nine months ended September 30, 2007 was due to \$5.3 million of net proceeds received from the issuance of common stock pursuant to stock option exercises, partially offset by \$0.3 million of costs paid during the nine months ended September 30, 2007 which had been incurred in connection with our initial public offering.

### ***Future Needs***

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

### **Contractual Obligations and Commitments**

The following table presents a summary of our future minimum payments under non-cancellable operating lease agreements and certain contractual obligations and commitments as of September 30, 2008 (in thousands, unaudited):

| <b>Years Ending December 31,</b> | <b>Operating<br/>Lease<br/>Obligations</b> | <b>Service and<br/>Licensing<br/>Obligations</b> | <b>Total<br/>Obligations</b> |
|----------------------------------|--|--|------------------------------|
| 2008 (3 months)                  | \$ 799                                     | \$ 259   | \$ 1,058                     |
| 2009                             | 2,594                                      | 489  | 3,083                        |
| 2010                             | 1,397                                      | 144  | 1,541                        |
| 2011                             | 1,140                                      |  | 1,140                        |
| 2012                             | 971  |  | 971                          |
| Total                            | \$ 6,901                                   | \$ 892   | \$ 7,793                     |

### ***Operating Lease Obligations***

We lease certain of our office, operating facilities, equipment and furniture and fixtures under various operating leases, the latest of which expires in December 2012. Certain of these leases have free or escalating rent payment provisions. We recognize rent expense on our operating leases on a straight-line basis over the terms of the leases, although actual cash payment obligations under certain of these agreements fluctuate over the terms of the agreements.

The operating leases for our headquarter facilities located in Mountain View, California expire in the second half of 2009.

### ***Service and Licensing Obligations***

We have entered into service and licensing agreements with third-party vendors to provide various services, including website development, website hosting, network access and software licensing. The terms of these services and licensing agreements are generally up to three years, the latest of which expires in September 2010. We record the related service and licensing expenses on a straight-line basis, although actual cash payment obligations under certain of these agreements fluctuate over the terms of the agreements.



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**Off-Balance Sheet Arrangements**

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

**Recent Accounting Pronouncements**

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

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**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*****Interest Rate Sensitivity***

As of September 30, 2008, we had cash and cash equivalents of \$90.5 million, which consisted primarily of cash and highly liquid money market instruments, commercial paper and U.S. government-sponsored enterprise debt securities with original maturities of 90 days or less from the date of purchase. We also had marketable securities of \$52.7 million, which consisted primarily of highly liquid U.S. government-sponsored enterprise and corporate debt securities, commercial paper and certificates of deposit with original maturities of more than 90 days but less than two years from the date of purchase and are available for use in current operations. Marketable securities that are available for use in current operations are classified as current assets in the accompanying condensed consolidated balance sheets regardless of the remaining time to maturity.

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we intend to maintain our portfolio of highly liquid cash equivalents and marketable securities in a variety of instruments, including money market funds, commercial paper, corporate and U.S. government-sponsored enterprise debt securities and certificates of deposit. We do not use financial instruments for trading or other speculative purposes, nor do we use leveraged financial instruments. Our investment policy limits investments to certain types of securities issued by institutions with investment-grade credit ratings and places restrictions on maturities and concentration by type and issue. The policy also prohibits investing in certain types of instruments including asset-backed securities, mortgage-backed securities, collateralized bond, debt and mortgage obligations, tax exempt securities, auction rate securities and derivatives. If overall interest rates had fallen by 10% during the three and nine months ended September 30, 2008, our interest income would have declined approximately \$0.1 million and \$0.3 million, respectively, assuming a consistent level in our cash, cash equivalents and marketable securities.

***Foreign Currency Exchange Risk***

To date, all of our revenue has been derived from transactions denominated in United States Dollars. We have exposure to adverse changes in exchange rates associated with operating expenses of our foreign operations, which are denominated in Chinese Yuan Renminbi. Foreign currency fluctuations have not had a material impact historically on our results of operations; however, there can be no assurance that future fluctuations will not have material adverse effects on our results of operations. We have not engaged in any foreign currency hedging or other derivative transactions to date.

***Credit Risk***

Our financial instruments that are exposed to concentrations of credit risk principally consist of cash, cash equivalents, marketable securities and accounts receivable. We deposit our cash, cash equivalents and marketable securities in accounts with major banks and financial institutions and, at times such marketable securities may be in excess of federally insured limits.

At September 30, 2008, we evaluated each of our investments with unrealized losses to determine if any other-than-temporary impairments existed in accordance with Emerging Issues Task Force ( EITF ) Abstract No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. Factors we considered included the financial condition and near-term prospects of the investee. Based upon our evaluation we do not consider these investments to be other-than-temporarily impaired at September 30, 2008.

We do not require collateral or other security for our accounts receivable. As of September 30, 2008, one carrier represented \$0.3 million, or 17%, of our total accounts receivable. We believe the potential for collection issues with any of our carriers is minimal. Accordingly, we have not recorded an allowance for uncollectible amounts at September 30, 2008.

**ITEM 4. CONTROLS AND PROCEDURES*****Evaluation of Our Disclosure Controls and Procedures***

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q.

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Based on management's evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods

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specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

### ***Changes in Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred during the three months ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ***Inherent Limitations on Effectiveness of Controls***

Our management, including our chief executive officer and chief financial officer, do not expect that our disclosure controls or our internal control over financial reporting will prevent all errors or all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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**PART II**

**OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

In the ordinary course of our business, we have received and may continue to receive inquiries from state regulators relating to various matters. We have become, and may in the future become, involved in litigation in the ordinary course of our business.

**Table of Contents****ITEM 1A. RISK FACTORS**

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

**Risks Related to Our Business**

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

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

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

*Our rate of growth may decline.*

We have a history of net losses and only achieved net profitability on an annual basis beginning in 2006. As of September 30, 2008, our accumulated deficit was \$21.5 million. We may in the future make significant expenditures related to the development of our business, including expenditures relating to marketing, website and technology development and hiring of additional personnel. In addition, we will continue to incur significant legal, accounting and other expenses as a public company. Although we have experienced revenue growth in prior periods, this growth may not be sustainable, and we may not achieve sufficient revenue to maintain profitability. Our future revenue growth will depend in large part upon our ability to continue to attract new individuals, families and small businesses to purchase health insurance through our ecommerce platform and to maintain our relationship with existing members within historical levels. We may not be able to maintain or exceed our historical membership growth rates, and to the extent that the rate of growth of our net new members slows (after accounting for member turnover), our revenue growth is also likely to slow. The commission rates that we receive for individuals and families are typically higher in the first twelve months of a policy. After the first twelve months, they generally decline significantly. Accordingly, to the extent that the rate of growth of our net new members slows, our revenue growth would slow due to a decline in commissions we receive for members whose policies have been active for more than twelve months in addition to the reduction in revenue growth that would occur solely as a result of a decline in our membership growth rate.

The commission rates we receive are impacted by a variety of factors, including the particular health insurance policies chosen by our members, the carriers offering those policies, the location of members and the laws and regulations in that jurisdiction and the amount of time policies have been active. Our commission rate per member could decrease as a result of either reductions in contractual commission rates or unfavorable changes in health insurance carrier override commission programs, each of which may be beyond our control and may occur on short notice. To the extent these factors cause our commission rate per member to decline, our rate of growth may decline.



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

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

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

consumers' willingness to conduct their own health insurance research;

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

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

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

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

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

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

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

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



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

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

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

The health insurance industry in the United States has experienced a substantial amount of consolidation over the past several years, resulting in a decrease in the number of health insurance carriers. In the future, we may be forced to offer insurance policies from a reduced number of insurance carriers or to derive a greater portion of our revenue from a more concentrated number of carriers as our business and the health insurance industry evolve. We derived 18% and 17% of our total revenue in the three months ended September 30, 2007 and 2008, respectively, from carriers owned by UnitedHealthcare. We derived 17% and 16% of our total revenue in the three months ended September 30, 2007 and 2008, respectively, from carriers owned by Wellpoint. We derived 12% and 14% of our total revenue in the three months ended September 30, 2007 and 2008, respectively, from Aetna. Our agreements with these carriers, entered into in the ordinary course of business, are terminable on short notice by either party for any reason. Notwithstanding our separate agreements with various carriers directly or indirectly owned by the same entity, certain carriers have attempted and may continue to attempt to consolidate our relationship with them, which could increase the impact of carrier concentration on us, decrease the commission rates we receive and adversely affect our financial results. Should our dependence on fewer carrier relationships increase (whether as a result of the termination of carrier relationships, further carrier consolidation or otherwise), we may become more vulnerable to adverse changes in our relationships with our carriers, particularly in states where we offer health insurance from a relatively smaller number of carriers or where a small number of carriers dominates the market, and our business, operating results and financial condition could be harmed.

From time to time, health insurance carriers may experience negative publicity as a result of consumer perception of, and reaction to, certain underwriting practices, news events or other matters. For example, health insurance carriers in California are experiencing negative publicity relating to allegations of violations of California's post-claims underwriting regulations. Negative publicity experienced by our carrier partners may in turn adversely affect us, even if we are not involved, due to our business relationship with the carriers. If it does, our business, operating results and financial condition could be harmed.

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

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

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

Our commission rates, and the commission override payments we receive from health insurance carriers for achieving sales volume thresholds or other objectives, are either set by each carrier or negotiated between us and each carrier. Carriers have altered, and may in the future alter, the contractual relationships we have with them, either by renegotiation or



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unilateral action. If these contractual changes result in reduced commissions, our business may suffer and our operating results and financial condition could be harmed. In addition, carriers periodically change the criteria they use for determining whether they are willing to insure individuals as well as other underwriting practices. Beginning in the second half of 2007, we believe that carriers have been applying more stringent underwriting criteria and practices to applications for health insurance and that this condition persisted in our quarter ended September 30, 2008. Changes such as these have in the past resulted in a decrease in the number of insurance policies submitted through our ecommerce platform that are approved. Changes in carrier underwriting criteria or practices could negatively impact sales of insurance policies on our ecommerce platform and could harm our business, operating results and financial condition.

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

We believe that maintaining and enhancing our brand identity is critical to our relationships with existing members, marketing partners and health insurance carriers and to our ability to attract new members, marketing partners and carriers. We are testing the use of television and radio advertisements as a means to enhance our brand. The promotion of our brand in these and other ways may require us to make substantial investments and we anticipate that, as our market becomes increasingly competitive, these branding initiatives may become increasingly difficult and expensive. Our brand promotion activities may not be successful or yield increased revenue, and to the extent that these activities yield increased revenue, the increased revenue may not offset the expenses we incur and our operating results could be harmed. If we do not successfully maintain and enhance our brand, our business may not grow and we could lose our relationships with health insurance carriers, marketing partners and/or members, which would harm our business, operating results and financial condition.

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

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

changes in consumer shopping behavior due to circumstances outside of our control, such as the economy;

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

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

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

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

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

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

competitive offerings.

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Our conversion rates can be impacted by changes in the mix of consumers referred to us through our member acquisition channels. For example, our conversion rates have historically been lower with respect to consumers referred to us by Internet lead aggregators and relatively higher with respect to consumers coming to us through our direct member acquisition channel. In addition, we may make changes to our ecommerce platform or undertake other initiatives in an attempt to improve consumer experience or for other reasons. These changes have in the past, and may in the future, have the unintended consequence of adversely impacting our conversion rates. A decline in the percentage of consumers who submit health insurance applications on our ecommerce platform could cause an increase in our cost of acquiring members as a result of increased costs on a per member basis.

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In the event the rate at which we convert consumers visiting our ecommerce platform into members does not continue to improve at our historical rate of improvement, our membership growth rate may decline, which could harm our business, operating results and financial condition. Our year-over-year growth rate for approved members from all products declined from 22% in the three months ended September 30, 2007 to 15% in the three months ended September 30, 2008. This decline was due to various factors, including an increase in the prior-year base used to compute the amount of growth in making the comparison, a decline in the growth rate of submitted health insurance applications and a decline in the rate at which submitted health insurance applications that were sent to our carriers were approved by our carrier partners.

We undertake initiatives in an attempt to improve the rate at which visitors to our ecommerce platform are converted into members. For instance, we previously developed our Electronic Processing Interchange (EPI) technology to simplify the health insurance enrollment process and better integrate our technology systems with those of health insurance carriers. The more our technology is integrated with our carrier partners, the more our application processing times, sales yields and processing costs improve. The third phase of our EPI technology, which we call eApproval, allows consumers to apply for health insurance online, electronically transmit signature and payment, receive an instant underwriting response and print membership material at the point of approval on our website. We initially launched our eApproval technology for use with individual and family health insurance with a carrier in California during the second quarter of 2008. The implementation of eApproval is dependent upon its adoption by health insurance carriers, and there can be no assurance that it will be implemented with any carrier in any specific timeframe or at all. In addition, there can be no assurance that any such implementation will impact our membership growth rate, improve sales yields or otherwise be effective. It is too early to determine the effectiveness of any technology or relationship that allows for expedited or instant underwriting, and the effectiveness of any such relationship or technology could be influenced by a number of factors, including sufficient carrier adoption of the technology and willingness to enter into the relationship, carrier allocation of resources, carrier commitment and ability to integrate their systems with ours and to provide expedited responses to insurance applications, system failures and process breakdowns, malfunctions, bugs or capacity constraints, the performance, reliability and availability of our ecommerce platform and underlying network infrastructure, ecommerce security risks, compliance with insurance and other laws and regulations and changes in laws and regulations. In addition, our implementation of eApproval may materially impact other aspects of our business. For example, the shorter the amount of time between submission of a health insurance application and coverage, the less there is a need for short term health insurance. In the event that we are not successful in integrating with our carrier partners to provide expedited underwriting, or if such integration is not effective in improving the rate at which we convert visitors into members, our membership growth rate may decline, which would harm our business, operating results and financial condition.

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

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

We rely in part upon third-party vendors, including data center and bandwidth providers, to operate our ecommerce platform. We cannot predict whether additional network capacity will be available from these vendors as we need it, and our network or our suppliers' networks might be unable to achieve or maintain a sufficiently high capacity of data transmission to allow us to process health insurance applications in a timely manner or effectively download data, especially if our website traffic increases. Any system failure that causes an interruption in or decreases the responsiveness of our services would impair our revenue-generating capabilities and harm our business and operating results and damage our reputation. In addition, any loss of data could result in loss of customers and subject us to potential liability. Our database and systems are vulnerable to damage or interruption from human error, earthquakes, fire, floods, power loss, telecommunications failures, physical or electronic break-ins, computer viruses, acts of terrorism, other attempts to harm our systems and similar events. In addition, our operations are vulnerable to earthquakes in the San Francisco Bay Area and elsewhere in Northern California. While we regularly back-up our system and store the system back-ups in a secure third-party offsite location with restricted access near the San Francisco Bay area, we do not yet have full second-site redundancy. Although we are in the process of implementing a second offsite data recovery system, there can be no assurance that the second-site will operate as designed or prevent a loss of data. If we were forced to rely on our system back-ups, we would experience significant delays in restoring the functionality of our website and could experience loss of data, which would harm our business and our operating results. Although we maintain insurance to cover a variety of risks, the scope and amount of our insurance coverage is not sufficient to cover our losses resulting from system failures or other disruptions to our online operations.

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Consumers may access our customer care center for assistance in connection with submitting health insurance applications through our ecommerce platform. We depend upon third parties, including telephone service providers, to operate our customer care center. Any failure of the systems that we rely upon in the operation of our customer care center could negatively impact sales of insurance policies through our ecommerce platform or our relationship with consumers and members, which could harm our business, operating results and financial condition.

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

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

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

We also purchase paid advertisements on search engines in order to attract consumers to our website. We typically pay a search engine for prominent placement of our name and website when particular health insurance-related terms are searched for on the search engine, regardless of the algorithmic search result listings. In some circumstances, the prominence of the placement of our name and website is determined by a combination of factors, including the amount we are willing to pay and algorithms designed to determine the relevance of our paid advertisement to a particular search term. As with algorithmic search result listings, search engines may revise the algorithms relevant to paid advertisements. These revisions may result in our having to pay increased amounts to maintain our paid advertisement placement in response to a particular search term. Additionally, we bid against our competitors and others for the display of these paid search engine advertisements. Many of our competitors, including many health insurance carriers, have greater resources with which to bid and better brand recognition than we do. We recently have experienced increased competition from carriers for both algorithmic search result listings and for paid Internet advertisements, which has increased our marketing and advertising expenses. If this competition increases significantly, or if the fees associated with paid search advertisements increase as a result of algorithm changes or other factors, our advertising expenses could rise significantly or we could reduce or discontinue our paid search advertisements, either of which could harm our business, operating results and financial condition. In addition, our cost of acquiring members is significantly dependent on the rate at which consumers who click on paid advertisements submit health insurance applications. If this rate does not improve consistent with our historical levels of improvement, our cost of acquisition could increase significantly.

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

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



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

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

the effectiveness of the marketing partner in marketing our website and services, including whether the marketing partner is successful in maintaining the prominence of its website in algorithmic search result listings and paid Internet advertisements;

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

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

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

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

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

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

***Economic and other factors beyond our control may negatively impact our business, operating results and financial condition.***

Our revenue depends upon demand for health insurance in the individual, family and small business markets, which can be influenced by a variety of factors beyond our control. For instance, we believe that an increasing number of individuals are becoming self-employed. In addition, as a result of substantial health insurance premium inflation in recent years, we believe that many employers are seeking to reduce the costs associated with providing health insurance to their employees, including offering fewer benefits to employees, reducing or eliminating dependent coverage, increasing employee health insurance premium contributions and eliminating health insurance benefits altogether. We also believe that demand in the individual and family health insurance market may increase as the employees of these employers look to other sources for their health insurance needs and as the number of self-employed individuals increases. We have no control over the economic and other factors that influence these trends, and they may reverse. If economic or other factors beyond our control negatively impact our business, our operating results and financial condition could be harmed.

We believe that we have been impacted by recent economic conditions. We cannot be certain of the future impact that a recession or challenging economic conditions would have on our business. A softening of demand for products and services offered by us, whether caused by changes in customer preferences or a weakening of the U.S. economy, including as a result of recent disruptions in the global financial markets or a decrease in general consumer confidence, may result in decreased revenue or growth. For instance, our year-over-year revenue growth declined from 31% in the second quarter of 2008 to 24% in the third quarter of 2008. Consumers may attempt to reduce expenses by cancelling existing health insurance purchased through us, determine not to purchase new health insurance through us, or purchase health insurance products with lower premiums for which we receive lower commissions. We experience a significant delay in learning about changes in our membership from health insurance carriers. Given this delay, we do not know to what extent the current challenging economic environment has impacted our membership retention rates. We do know that we experienced small increases in member turnover in the fourth quarter of 2007 and the first quarter of 2008. To the extent the economy adversely impacts our membership retention or the number or type of health insurance applications submitted through us and that are approved by our health insurance carrier partners, our rate of growth will decline and our business and operating results will be harmed. A recessionary environment could also negatively impact the health insurance carriers whose products are offered on our ecommerce platform, and they may, among other things, determine to reduce their commission rates, increase premiums or

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reduce benefits, change their underwriting practices so that fewer consumers health insurance applications are approved or decrease the amount they are willing to spend for marketing purposes, all of which would negatively impact our sale of health insurance as well as our sponsorship and technology licensing businesses.

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In addition, interest rates recently have declined, and may continue to decline, in response to weak economic conditions, and we have experienced a significant reduction in the rate of return on our investments both as a result of the decline in interest rates and as a result of our implementation of more conservative investment policies. Weak economic conditions have also affected the value of certain of our marketable securities. As of September 30, 2008, we had accumulated net unrealized losses on certain of our marketable securities of \$0.4 million. Although we do not consider these investments to be other-than-temporarily impaired at September 30, 2008, we can provide no assurance that continued weak economic conditions will not further affect the value of our marketable securities resulting in the realization of material impairment losses. These and other negative impacts of weak economic conditions in the United States could have a negative impact on our business, operating results and financial condition.

***We face risks in the event that we pursue new strategies and opportunities in segments of the health insurance market in which we do not currently operate.***

We evaluate and explore new strategies and opportunities in segments of the health insurance market in which we do not currently operate, such as Medicare, where we may be able to leverage our technology. We may not adopt these new strategies, and even if we do, we cannot predict whether demand for any new product or service that we offer will result in increased membership or revenue. In addition, modifying our ecommerce platform or creating a new platform for these opportunities may be time consuming and expensive, and our pursuit of them would expose us to laws, regulations and business practices with which we are unfamiliar. If we are unable to successfully introduce new products and adopt new strategies for the growth of our business, our business and financial condition may be harmed.

***We rely on health insurance carriers to accurately and regularly prepare commission reports, and if these reports are inaccurate or not sent to us in a timely manner, our business and operating results could be harmed. We also may not recognize trends in our membership as a result of a lack of information from health insurance carriers.***

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

We also are dependent on our carrier partners and others for data related to our membership. For instance, with respect to health insurance products other than small business group health insurance, our carrier partners do not directly report member cancellations to us, resulting in the need for us to determine cancellations using payment data that carriers provide. We infer cancellations from this payment data by analyzing whether payments from members have ceased for a period of time, and we may not learn of a cancellation for several months, given that some of our members pay on a schedule less frequently than monthly (e.g., quarterly). With respect to our small business group membership, many groups notify the carrier directly with respect to increases or decreases in group size and policy cancellations. Our insurance carrier partners often do not communicate this information to us, and it often takes a significant amount of time for us to learn about small business group cancellations and changes in our membership within the group itself. We often are not made aware of policy cancellations until the time of the group's annual renewal.

After we have estimated membership for a period, we may receive information from health insurance carriers that would have impacted the estimate if we had received the information prior to the date of estimation. We may receive commission payments or other information that indicates that a member who was not included in our estimates for a prior period was in fact an active member at that time, or that a member who was included in our estimates was in fact not an active member of ours. We also reconcile information carriers provide to us and may determine that we were not historically paid commissions owed to us, which would cause us to have underestimated our membership. Additionally, carriers may require us to return commission payments paid in a prior period due to policy cancellations for members we previously estimated as being active. For various reasons, including if current trends in membership cancellation are inconsistent with past cancellation trends that we use to estimate our membership or if carriers subsequently report changes to the commission payments that they previously reported to us, our actual membership could be different from our estimates, perhaps materially. Total revenue per estimated member for the period would also change if our estimated membership changed. Our estimate regarding the average amount of time our members maintain their health insurance products also could be inaccurate as it is dependent upon the accuracy of our membership estimates.

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

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

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

The market for selling health insurance products is intensely competitive and the sale of health insurance over the Internet is new and rapidly evolving. Consumers have the ability to use several sources other than our ecommerce platform to research and purchase health insurance. In addition, consumers can research health insurance using our ecommerce platform and purchase their health insurance through one of our competitors. We compete directly with health insurance carriers, including many of the carriers that offer health insurance through our ecommerce platform. Many carriers market and sell their health insurance plans, including those that are offered on our ecommerce platform, directly to consumers using call centers, their own websites and other means.

We also compete with a large number of local insurance agents across the United States that sell health insurance products in their local communities. Some of these traditional insurance agents utilize the Internet in various ways to acquire their customers. For instance, some local agents use lead aggregator services that use the Internet to find consumers interested in purchasing health insurance and are compensated for referring those consumers to the traditional agent. As we do, lead aggregators often use Internet search engines and other forms of online advertising to drive Internet traffic to the lead aggregator's website. We compete with lead aggregators for these consumers, and some lead aggregators have begun to use quoting and plan comparison tools similar to ours. In addition to traditional agents, a number of agents operate websites that provide some form of online shopping experience for consumers interested in purchasing health insurance. Although some of these online agents only sell health insurance in a limited number of states and/or represent only a limited number of health insurance carriers, these agents could expand their service area and product offerings.

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

undertake more extensive marketing campaigns for their brands and services;

devote more resources to website and systems development;

negotiate more favorable commission rates and commission override payments; and

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

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

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

A portion of our operations is conducted in China. Among other things, we use employees in China to maintain and update our ecommerce platform. This and other information is delivered to us through secured communications over the Internet. Our business would be harmed if this connection temporarily failed, and we were prevented from promptly updating our software or implementing other changes to our database and

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systems. Our operations in China also expose us to different and unfamiliar laws, rules and regulations, including different intellectual property laws, which are not as protective of our intellectual property as the laws in the United States, and different labor and tax laws. United States and

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Chinese trade laws may impose restrictions on the importation of programming or technology to or from the United States. These risks could cause us to incur increased expenses and could harm our ability to effectively and successfully manage our operations in China, which in turn could cause our business, operating results and financial condition to suffer. We plan to continue to expand our Chinese operations. These plans will require additional management attention and resources and may be unsuccessful, as we have limited experience with respect to operations in China.

In addition, our subsidiary in China has a subsidiary business insurance agency license in the Fujian province in China pursuant to which we are piloting the sale of health, accident and life insurance in the Fujian province. Our license is up for renewal at the end of 2011. We also have entered into a relationship with a local insurance agency outside the Fujian province in Shanghai, China, pursuant to which we offer the local insurance agency's insurance products in Shanghai on our website. We have no prior experience marketing or selling insurance in China or in adapting our business and ecommerce platform to Chinese markets and cultures, legal and regulatory regimes or business customs. For instance, the laws and regulations applicable to our marketing and selling insurance online in China are unclear, and our operations may be in violation of them. The consequences of violating insurance laws and regulations in China are unclear, but they could result in the termination of our license and could harm our business as a whole. For various reasons, we may not expand the pilot program to other geographic areas, and even if we do, there can be no assurance that our ecommerce platform in China would ever generate a significant amount of revenue or otherwise be successful. Our success in establishing an insurance business in China is dependent upon many of the factors that influence the success of our business in the United States, including, but not limited to, our receiving regulatory approvals (including the renewal of our license), acceptance of the Internet and our ecommerce platform as a marketplace for the purchase of insurance, our success in marketing our ecommerce platform and in retaining members who purchase insurance through that platform, our ability to enter into and maintain relationships with insurance carriers, commission rates, the affordability of the insurance products offered, insurance carrier business practices, the effectiveness with which we establish a brand identity, performance, reliability and availability of our ecommerce platform, competition, the regulatory and healthcare reimbursement environment and changes to the environment, our ability to attract qualified personnel and network security.

Our participation and success in the Shanghai market may be impacted by additional factors given that the insurance products offered on our website are offered through another insurance agent, including our dependence on a single insurance agent for the products on our website, the agent's relationship with insurance carriers and consumers, the agent's ability to maintain its licenses and regulatory approvals, and the number, quality and attractiveness of the insurance products offered by the agent. While there is no certainty that we would be able to expand our presence in the insurance industry in China, we may attempt to do so. If we decide to do so, we may need to receive additional government licenses and approvals or enter into additional relationships and may face disadvantages in doing so as a result of our subsidiary in China being wholly foreign owned.

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

We sell advertising space to health insurance carriers on our website through our sponsorship advertising program. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. Our sponsorship advertising initiative is relatively new and, if we do not continue to successfully increase our revenue from the sale of sponsorship advertising, our rate of growth may decline. Current economic conditions have adversely impacted the advertising industry in general. To the extent that they impact the amount health insurance carriers are willing to pay for advertising on our ecommerce platform, our sponsorship advertising program will be adversely impacted. The success of our sponsorship advertising program is dependent upon a number of factors, including the effectiveness of the sponsorship advertising program as a cost-effective method for carriers to obtain additional members, consumer and health insurance carrier adoption of the Internet and our ecommerce platform as a medium for the purchase and sale of health insurance, our ability to attract consumers visiting our ecommerce platform and convert those consumers into members, the existence of a relationship between us and a diverse group of carriers that offer a number of health insurance plans in the markets in which we attempt to sell sponsorship advertising, the cost and other features of the health insurance product that is the subject of the sponsorship advertising, the impact the sponsorship advertising has on the sale of the health insurance product that is the subject of the advertising and the effectiveness of the carrier's other means of advertising. In addition, while our practice of selling sponsorship advertising is described on our ecommerce platform, it could cause consumers to perceive us as not objective, which could harm our brand and result in a decline in our health insurance sales. It also could adversely impact our relationship with health insurance carriers that do not purchase our sponsorship advertising. As a result, our business, operating results and financial condition could be harmed.

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

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

***Our HSA platform may not be successful.***

We are in the process of developing a business health savings account (HSA) platform to facilitate employer contributions to employee HSAs. We have entered into a relationship with a third party that helped to develop and assists in administering the HSA component of the platform, including its HSA bank account component. This third party has the relationship with one or more banks that may act as custodian of the HSAs established in connection with the platform. The success of the business HSA platform will depend upon a number of factors, including the attractiveness of the platform to businesses and employees; our effectiveness in engaging partners, such as associations, banks and other financial services partners, to market the platform; our ability to otherwise successfully market the platform and make it understandable and easy to navigate; our ability to maintain an effective relationship with the third party that assists in administering the HSA component of the platform; our ability and this third party's ability to maintain a relationship with a bank that acts as custodian for the HSAs opened using the platform; our ability to enter into and maintain a relationship with a bank that will act as processor for the debit cards that relate to the HSAs opened using the platform; the ability of the third party and a bank to successfully manage and operate the HSA aspects of the platform; our ability and the ability of the third party and relevant bank to avoid process breakdowns, malfunctions, technical difficulties and bugs in the platform; the performance, reliability and availability of the platform and our success in training our customer care center representatives to adequately serve consumers desiring assistance with respect to HSAs. We are dependent upon third parties to operate the platform, and the platform's success depends in part on our ability to maintain effective relationships with those parties as well as their allocation of sufficient resources and commitment to develop the platform within certain timeframes.

The insurance, banking and other laws and regulations applicable to the platform are complicated and in some cases unclear. For example, it is possible that certain states could take the position that the platform or marketing individual insurance into businesses violates certain laws and regulations, including those relating to the sale of insurance to small businesses. The HSA platform also increases our potential exposure under laws and regulations relating to privacy and security as we have access to certain financial and confidential information of consumers using the platform. In light of legal and regulatory risks, we may determine not to launch the platform in certain states. Regardless, we could be subject to adverse legal and regulatory action in any state from departments of insurance and otherwise and may need to cease offering the platform in those states. If the business HSA platform is not successful, our business and operating results could be harmed and our rate of growth may decline.

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

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





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divert our management's attention and may result in a court determining that our intellectual property rights are unenforceable. If we are not successful in cost-effectively protecting our intellectual property rights, our business, operating results and financial condition could be harmed.

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

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

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

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

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

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

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

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the cost of maintaining insurance increases, our operating expenses will rise, which could harm our business, operating results and financial condition. A significant amount of publicity has been generated regarding the adverse impact of current economic conditions on the health of companies providing insurance that covers business related risks and liabilities. To the extent the economy impacts insurers with which we have a relationship, and those insurers are unable, or make it more difficult, to reimburse us for losses that were insured, our business, operating results and financial condition could be harmed.

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

Our success is dependent upon the performance of our senior management and key personnel. Our management and employees can terminate their employment at any time, and the loss of the services of any of our executive officers or key employees could harm our business. For example, we are required to appoint a single writing agent with each insurance carrier with which we have a relationship in every state. Currently a single part-time employee acts as writing agent with respect to some carriers with which we have a relationship; however, we are now in the process of transferring the duties of writing agent for those carriers to an existing executive officer and appointing a back-up writing agent. If we lose the service of our appointed writing agent, the duties of writing agent will need to be transitioned to other company personnel. Due to our national reach and the large number of carrier partners whose policies are purchased by our members, this transition may be difficult and requires a significant period of time to complete, even if we have a back-up writing agent. If the transition is not successful or takes too long to complete, our agency relationship with particular insurance carriers may be terminated, our commission payments could be discontinued or delayed and, as a result, our business and operating results could be harmed. Our success is also dependent upon our ability to attract additional personnel for all areas of our organization. We may not be successful in attracting and retaining personnel on a timely basis, on competitive terms or at all. If we are unable to attract and retain the necessary personnel, our business would be harmed.

All of our senior management and key employees have sold shares of our common stock in the open market, and some have sold a significant portion of their vested holdings. These employees may be more likely to leave us given that they have liquidated some or a substantial percentage of their holdings. Our senior management and key employees work for us on an at-will basis and our business could be harmed if we lose their services.

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

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

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

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

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

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

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

an acquisition undertaken for strategic business purposes may negatively impact our results of operations;

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

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

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

the acquired businesses, products or technologies may not generate sufficient revenue to offset acquisition costs or to maintain our rate of growth;

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

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

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

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

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

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

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We have a complex business organization. Ensuring that we have adequate internal financial and accounting controls and procedures in place to help ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. During 2007, we documented our internal controls and procedures in connection with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in each Annual Report on Form 10-K. Section 404 also requires our independent registered public accounting firm to report on our internal control over financial reporting.

Our management, including our chief executive officer and chief financial officer, does not expect that our internal control over financial reporting will prevent all errors or all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two

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or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

As a result, we cannot assure that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding disclosure controls and the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

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

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, or SFAS 123R. SFAS 123R requires measurement of all employee stock-based compensation awards using a fair value method and the recording of such expense in the condensed consolidated financial statements. The adoption of SFAS 123R requires additional accounting related to the income tax effects, and additional disclosure regarding the cash flow effects, resulting from share-based payment arrangements. We adopted SFAS 123R on January 1, 2006. As permitted, we will continue to account for the portion of awards outstanding on or before December 31, 2005 using the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretative guidance. During the three months ended September 30, 2007 and 2008, we recorded stock-based compensation expense totaling \$0.3 million and \$0.9 million, respectively, related to stock options, restricted stock awards and restricted stock units granted to employees and accounted for in accordance with the provisions of SFAS 123R. Total unamortized stock-based compensation cost related to these stock options, restricted stock awards and restricted stock units at September 30, 2008 was approximately \$12.2 million, net of estimated forfeitures of \$1.3 million. This amount will be amortized on a straight-line basis and will be adjusted for subsequent changes in estimated forfeitures. We expect to continue to grant additional equity awards in the future and that the impact of expenses related to those grants will be material over time.

***Changes in our provision for income taxes or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our results.***

Our provision for income taxes is subject to volatility and could be adversely affected by earnings differing materially from our projections; by changes in the valuation of our deferred tax assets and liabilities; by expiration of or lapses in the research and development tax credit laws; by tax effects of share-based compensation; or by changes in tax laws, regulations, accounting principles, including accounting for uncertain tax positions, or interpretations thereof. For instance, on September 23, 2008, the state of California approved budget legislation which substantially limits the utilization of net operating losses and tax credits. The new law does not affect the amount of net operating losses and tax credits that we expect to ultimately use to offset future California taxes, but limits the amount we can utilize in 2008 and 2009, resulting in an increase in cash taxes in those years. Since the majority of our state taxes are in California, where our headquarters are located, we expect that our cash outlay for federal and state taxes will increase to approximately 4.5% of pre-tax income for the year ending December 31, 2008, up from our previous expectation of approximately 3% of pre-tax income, as a result of this new law.

Significant judgment is required to determine the recognition and measurement attribute prescribed in Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), which we adopted on January 1, 2007. In addition, FIN 48 applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes or additional paid-in capital. In addition, we are subject to examinations of our income tax returns by the Internal Revenue Service and other tax authorities. We assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There may be exposure that the outcomes from these examinations will have an adverse effect on our operating results and financial condition.

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

We currently do not sell health insurance or license our technology platform outside the United States other than in China. Our subsidiary in China recently launched pilot programs to market and sell insurance online in the city of Xiamen in the Fujian province of China and outside the Fujian province in Shanghai, China. We may attempt to expand our pilot programs to additional geographic regions. We face significant challenges in connection with expanding our business into any foreign country, since we have no prior experience marketing or selling insurance in any foreign jurisdiction. Additionally, demand for private health insurance is not significant in many foreign countries as a result of government-sponsored healthcare systems. In addition to facing many of the same challenges we face domestically, we also would have to overcome other obstacles such as:

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

varied, unfamiliar and unclear legal and regulatory restrictions;

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

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

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

### **Risks Related to Insurance Regulation**

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

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

grant and revoke licenses to transact insurance business;

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

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

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

approve which entities can be paid commissions from carriers;

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

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

impose fines and other penalties; and

impose continuing education requirements.

Due to the complexity, periodic modification and differing interpretations of insurance laws and regulations, we may not have always been, and we may not always be, in compliance with them. We would face increased risk in this regard if we were to pursue opportunities to sell products in segments of the health insurance market in which we do not currently operate, such as Medicare or limited benefit products. Failure to comply with insurance laws and regulations or other laws and regulations applicable to or business could result in significant liability, additional department of insurance licensing requirements or the revocation of licenses in a particular jurisdiction, which could significantly increase our operating expenses, prevent us from transacting health insurance business in a particular jurisdiction and otherwise harm our business, operating results and financial condition. Moreover, an adverse regulatory action in one jurisdiction could result in penalties and adversely affect our license status or reputation in other jurisdictions due to the requirement that adverse regulatory

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actions in one jurisdiction be reported to other jurisdictions. Even if the allegations in any regulatory or other action against us are proven false, any surrounding negative publicity could harm consumer, marketing partner or health insurance carrier confidence in us, which could significantly damage our brand. Because some consumers, marketing partners and health insurance carriers may not be comfortable with the concept of purchasing health insurance using the Internet, any negative publicity may affect us more than it would others in the health insurance industry and would harm our business, operating results and financial condition.

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

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

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

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

In some states, guaranteed issue laws have or could be coupled with related measures that may impact our business. For example, a proposal in California included a combination of a number of items, including a guaranteed issue component, a mandate that requires all individuals to purchase or otherwise obtain health insurance and a requirement that health insurance carriers spend 85% or more of premium revenue on patient care. Additionally, the President elect has expressed his views with respect to healthcare reform at a general level, but has not proffered a detailed proposal. Given the generality with which he has expressed his views, it is not possible for us to predict the impact of any healthcare reform on our business. We cannot be certain of the impact of any new legislation at the state or federal level, but it could harm our business, operating results and financial condition. In addition, speculation regarding healthcare reform or potential changes in the regulatory environment in which we operate creates uncertainties that could lead to increased volatility and a reduction in our stock price in the short term.

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

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

Our business depends upon the private sector of the United States health insurance system, its relative role in financing healthcare delivery and health insurance carriers use of agents and brokers to market their products. Fundamental changes to this system or in the manner in which health insurance is distributed in the United States could reduce or eliminate the



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demand for private health insurance for individuals, families and small businesses or increase our competition, which would harm our business. Recently, there has been substantial national and state attention and debate regarding the fairest and most effective method of healthcare reimbursement. For instance, some advocates promote a single-payer healthcare system that would be largely underwritten by the state or federal government. The adoption of state or federal laws that promote or establish a government-sponsored healthcare system could reduce or eliminate the number of individuals, families and small businesses seeking or permitted to purchase private health insurance or supplemental coverage, which would substantially reduce the demand for our service and harm our business, operating results and financial condition.

Other proposals seek to provide health insurance coverage to all individuals, but do so by maintaining many key aspects of the private sector health insurance system rather than proposing a government sponsored system. We do not know what impact the adoption of proposals like these would have on our business, but they could, if implemented, harm our business, operating results and financial condition.

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

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

Our services involve the collection and storage of confidential information of consumers and the transmission of this information to their chosen health insurance carriers. For example, we collect names, addresses, Social Security and credit card numbers, and information regarding the medical history of consumers in connection with their applications for health insurance. We cannot guarantee that we will be free of security breaches. We may be required to expend significant capital and other resources to protect against security breaches or to alleviate problems caused by security breaches. Despite our implementation of security measures, techniques used to obtain unauthorized access or to sabotage systems change frequently. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any compromise or perceived compromise of our security could damage our reputation and our relationship with our members, marketing partners and health insurance carriers, could reduce demand for our services and could subject us to significant liability as well as regulatory action, which would harm our business, operating results and financial condition.

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

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

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

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

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

Consumers using our website depend upon Internet, online and other service providers for access to our website. Many of these service providers have experienced significant outages, delays and other difficulties in the past and could experience them in the future. Any significant interruption in access to our website or increase in our website's response time as a result of these difficulties could damage our relationship with insurance carriers, marketing partners and existing and potential members and could harm our business, operating results and financial condition.



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

*The trading price of our common stock may be subject to significant fluctuations and volatility, and our stockholders may be unable to resell their shares at a profit.*

The stock markets, in general, and the markets for high technology stocks in particular, have experienced high levels of volatility. The market for technology stocks has been extremely volatile and frequently reaches levels that bear no relationship to the past or present operating performance of those companies. These broad market fluctuations may adversely affect the trading price of our common stock. In addition, the trading price of our common stock has been subject to significant fluctuations and may continue to fluctuate or decline. Factors that could cause fluctuations in the trading price of our common stock include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of technology companies in general, and companies in our industry;

actual or anticipated changes in our results of operations or fluctuations in our operating results;

actual or anticipated changes in the expectations of investors or securities analysts, including changes in financial estimates or investment recommendations by securities analysts who follow our business and changes in perceptions relating to the economy;

speculation in the press or investment community;

technological advances or introduction of new products by us or our competitors;

actual or anticipated developments in our competitors' businesses or the competitive landscape generally;

litigation involving us, our industry or both;

actual or anticipated regulatory developments in the United States, foreign countries or both;

major catastrophic events;

announcements or developments relating to the economy;

our sale of common stock or other securities in the future;

the trading volume of our common stock, as well as sales of large blocks of our stock; or

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departures of key personnel.

These factors, as well as general economic and political conditions and the announcement of proposed and completed acquisitions or other significant transactions, or any difficulties associated with such transactions, by us or our strategic partners, customers or our current competitors, may materially adversely affect the market price of our common stock in the future. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against that company. Such litigation could result in substantial cost and a diversion of management's attention and resources. In addition, volatility, lack of positive performance in our stock price or changes to our overall compensation program, including our equity incentive program, may adversely affect our ability to retain key employees.

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

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

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

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

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

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

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

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

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

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

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**ITEM 6. EXHIBITS**

(a) Exhibits

Except as so indicated in Exhibits 32.1 and 32.2, the following exhibits are filed as part of, or incorporated by reference into, this quarterly report.

| <b>Exhibit Number</b> | <b>Description of Exhibit</b>   |
|-----------------------|---|
| 31.1                  | Certification of Gary L. Lauer, Chief Executive Officer of eHealth, Inc., pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.      |
| 31.2                  | Certification of Stuart M. Huizinga, Chief Financial Officer of eHealth, Inc., pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1                  | Certification of Gary L. Lauer, Chief Executive Officer of eHealth, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.           |
| 32.2                  | Certification of Stuart M. Huizinga, Chief Financial Officer of eHealth, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.      |

Filed herewith.

Furnished herewith.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on the 10<sup>th</sup> day of November 2008.

/s/ GARY L. LAUER  
Gary L. Lauer  
*Chief Executive Officer*  
*(Duly Authorized Officer on Behalf of the Registrant)*

/s/ STUART M. HUIZINGA  
Stuart M. Huizinga  
*Chief Financial Officer*  
*(Principal Financial Officer)*

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