PLANETOUT INC
Form 10-Q
August 09, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

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

For the quarterly period ended: June 30, 2006

or

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

For the transition period from __________ to __________

Commission File Number: 000-50879

PLANETOUT INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**94-3391368**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1355 SANSOME STREET, SAN FRANCISCO, CALIFORNIA	**94111**
(Address of Principal Executive Offices)	(Zip Code)

(415) 834-6500

(Registrant s Telephone Number, Including Area Code)

(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.þ Yes o No

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The number of shares outstanding of the registrant s Common Stock, $0.001 par value, as of August 1, 2006 was 17,489,562.

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For the Quarter ended June 30, 2006

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PART I
FINANCIAL INFORMATION
PlanetOut Inc.
Item 1. Unaudited Condensed Consolidated Financial Statements
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	December 31, 2005	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,461	$ 4,877
Restricted cash		4,793
Accounts receivable, net	6,030	7,839
Inventory	1,349	1,390
Prepaid expenses and other current assets	2,571	10,056
Total current assets	28,411	28,955
Property and equipment, net	8,167	8,449
Goodwill	28,699	32,572
Intangible assets, net	10,909	12,934
Other assets	1,152	1,602
Total assets	$ 77,338	$ 84,512
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,334	$ 1,626
Accrued liabilities	2,750	3,316
Accrued restructuring		793
Deferred revenue, current portion	8,749	13,303
Capital lease obligations, current portion	309	293
Notes payable, current portion	222	2,446
Deferred rent, current portion	286	345
Total current liabilities	13,650	22,122
Deferred revenue, less current portion	1,771	2,268
Capital lease obligations, less current portion	212	434
Notes payable, less current portion	7,075	4,716
Deferred rent, less current portion	1,578	1,477
Total liabilities	24,286	31,017

Minority interest in consolidated subsidiaries		47
Stockholders equity:		
Common stock: $0.001 par value, 100,000 shares authorized, 17,248 and 17,340 shares issued and outstanding at December 31, 2005 and June 30, 2006, respectively	17	17
Additional paid-in capital	88,333	88,625
Note receivable from stockholder	(603)	
Accumulated other comprehensive loss	(123)	(136)
Accumulated deficit	(34,572)	(35,058)
Total stockholders equity	53,052	53,448
Total liabilities and stockholders equity	$ 77,338	$ 84,512

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

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PlanetOut Inc.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
Revenue:				
Advertising services	$ 2,566	$ 7,318	$ 3,958	$ 12,665
Subscription services	5,172	6,321	10,025	12,591
Transaction services	332	2,656	752	8,612
Total revenue	8,070	16,295	14,735	33,868
Operating costs and expenses: (*)				
Cost of revenue	2,320	6,872	4,445	16,302
Sales and marketing	2,532	4,427	4,988	8,371
General and administrative	1,615	3,078	2,863	6,158
Restructuring		834		834
Depreciation and amortization	848	1,300	1,668	2,524
Total operating costs and expenses	7,315	16,511	13,964	34,189
Income (loss) from operations	755	(216)	771	(321)
Equity in net loss of unconsolidated affiliate	(16)		(25)	
Interest expense	(30)	(201)	(68)	(398)
Other income, net	313	110	552	280
Income (loss) before income taxes and minority interest	1,022	(307)	1,230	(439)
Provision for income taxes	(12)		(41)	
Minority interest in gain of consolidated affiliate		(47)		(47)
Net income (loss)	$ 1,010	$ (354)	$ 1,189	$ (486)
Net income (loss) per share:				
Basic	$ 0.06	$ (0.02)	$ 0.07	$ (0.03)
Diluted	$ 0.06	$ (0.02)	$ 0.07	$ (0.03)
Weighted-average shares used to compute net income (loss) per share:				

Basic		17,092		17,315		17,015		17,288
Diluted		18,249		17,315		18,192		17,288
(*) Includes stock-based compensation (benefit) as follows (see Note 2):								
Cost of revenue	$	15	$	1	$	27	$	6
Sales and marketing		18		1		25		2
General and administrative		109		(101)		66		(22)
Total stock-based compensation (benefit)	$	142	$	(99)	$	118	$	(14)

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

PlanetOut Inc.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six months ended June 30,	
	2005	**2006**
Cash flows from operating activities:		
Net income (loss)	$ 1,189	$ (486)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,668	2,524
Provision for doubtful accounts	26	226
Restructuring		41
Stock-based compensation expense (benefit)	118	(14)
Amortization of deferred rent	224	(40)
Loss on disposal or write-off of property and equipment	(1)	21
Equity in net loss of unconsolidated affiliate	25	
Minority interest		47
Changes in operating assets and liabilities, net of acquisition effects and restructuring:		
Accounts receivable	(368)	(1,774)
Inventory		(41)
Prepaid expenses and other assets	289	(3,216)
Accounts payable	(1,384)	216
Accrued and other liabilities	690	528
Accrued restructuring		793
Deferred revenue	635	(1,311)
Net cash provided by (used in) operating activities	3,111	(2,486)
Cash flows from investing activities:		
Acquisitions, net of cash acquired		(5,403)
Purchases of property and equipment	(2,659)	(1,554)
Changes in restricted cash		(4,793)
Net cash used in investing activities	(2,659)	(11,750)
Cash flows from financing activities:		
Proceeds from exercise of common stock options and warrants	431	306
Proceeds from repayment of note receivable from stockholder		843
Principal payments under capital lease obligations and notes payable	(774)	(484)
Net cash provided by (used in) financing activities	(343)	665
Effect of exchange rate on cash and cash equivalents	(8)	(13)

Net increase (decrease) in cash and cash equivalents		101		(13,584)
Cash and cash equivalents, beginning of period		43,128		18,461
Cash and cash equivalents, end of period	$	43,229	$	4,877
Supplemental disclosure of noncash flow investing and financing activities:				
Property and equipment and related maintenance acquired under capital leases	$	34	$	651
Unearned stock-based compensation	$	399	$	

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

PlanetOut Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company

PlanetOut Inc. (the Company) is a leading global media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender, or LGBT, community. The Company serves this audience through a wide variety of media properties, including leading LGBT-focused websites, such as Gay.com, PlanetOut.com, Advocate.com and Out.com, and magazines, such as *The Advocate, Out, The Out Traveler* and *HIVPlus*, among others. Through these media properties and other marketing vehicles, such as live events, the Company generates revenue from a combination of advertising, subscription and transaction services, including those obtained in the Company s acquisition in November 2005 of LPI Media, Inc. and related entities (LPI). The Company also expanded the number and scope of its subscription service offerings with this acquisition. In addition to premium subscriptions on its Gay.com and PlanetOut.com services, the Company offers its customers subscriptions to eight other online and print products and services.

Through the Company s acquisition in March 2006 of RSVP Productions, Inc. (RSVP), the Company also became a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. The Company also offers its customers access to specialized products and services through its transaction-based websites, including Kleptomaniac.com and BuyGay.com, that generate revenue through sales of products and services of interest to the LGBT community, including fashion, video and music products. The Company generates transaction revenue from third-party websites and partners for the sale of products and services to its users as well as through newsstand sales of its various print properties.

Note 2 Basis of Presentation and Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared and reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to state fairly the financial position and the results of operations for the interim periods. The balance sheet at December 31, 2005 has been derived from audited financial statements at that date. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), but omit certain information and footnote disclosures necessary to present the statements in accordance with generally accepted accounting principles. Results of interim periods are not necessarily indicative of results for the entire year. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Principles of Consolidation

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

Reclassifications

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates and assumptions made by management include, among others, the assessment of collectibility of accounts receivable, the determination of the

allowance for doubtful accounts, the determination of the reserve for inventory obsolescence, the determination of the fair market value of its common stock, the valuation and useful life of its capitalized software and long-lived assets and the valuation of deferred tax asset balances. Actual results could differ from those estimates.

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Restricted Cash

Restricted cash consists of cash that is restricted as to future use by contractual agreements associated with irrevocable letters of credit relating to a lease agreement for one of the Company s offices in New York and relating to a lease agreement with a cruise line securing future deposit commitments required under that agreement. Approximately $2,050,000 of the restricted cash related to future deposit commitments will be applied against the commitments for future deposits during the remainder of 2006 and approximately $2,583,000 of the restricted cash related to future deposit commitments will be applied against the commitments for future deposits in March 2007.

Inventory

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

Property and Equipment

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

Leasehold improvements made by the Company and reimbursable by the landlord as tenant incentives are recorded by the Company as leasehold improvement assets and amortized over a term consistent with the above guidance. The incentives from the landlord are recorded as deferred rent and amortized as reductions to rent expense over the lease term. At December 31, 2005 and June 30, 2006, the balance of these leasehold improvement allowances was $1,402,000. During the three months ended June 30, 2005 and 2006, the Company amortized $47,000 and $49,000, respectively, as a reduction of rent expense in the accompanying unaudited condensed consolidated statements of operations. During the six months ended June 30, 2005 and 2006, the Company amortized $92,000 and $97,000, respectively, as a reduction of rent expense in the accompanying unaudited condensed consolidated statements of operations. At December 31, 2005 and June 30, 2006, the deferred rent balance attributable to these incentives totaled $1,179,000 and $1,082,000, respectively. Future amortization of the balance of these tenant incentives is estimated to be $96,000 for the six remaining months of 2006, $194,000 each year for 2007 to 2011, and $16,000 in 2012. At December 31, 2005 and June 30, 2006, the Company had receivable balances for tenant incentives of $243,000 and zero, respectively, recorded under prepaid expenses and other current assets in the accompanying unaudited condensed consolidated balance sheets.

Internal Use Software and Website Development Costs

The Company capitalizes internally developed software costs in accordance with the provisions of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1) and Emerging Issues Task Force (EITF) Abstract No. 00-02, *Accounting for Web Site Development Costs* (EITF 00-02). Capitalized costs are amortized on a straight-line basis over the estimated useful life of the software, generally three years, once it is available for its intended use. During the three months ended June 30, 2005 and 2006, the Company capitalized costs of $573,000 and $456,000, respectively, and recorded $207,000 and $339,000 of related amortization expense, respectively. During the six months ended June 30, 2005 and 2006, the Company capitalized costs of $1,190,000 and $779,000, respectively, and recorded $381,000 and $664,000 of related amortization expense, respectively. The capitalized costs for the three months ended June 30, 2005 and 2006 included $316,000 and $87,000, respectively, paid to external consultants for website development. The capitalized costs for the six months ended June 30, 2005 and 2006 included $715,000 and $202,000, respectively, paid to external consultants for website development.

Goodwill

The Company accounts for goodwill using the provisions of Statement of Financial Accounting Standards (SFAS) No. 142 (FAS 142), *Goodwill and Other Intangible Assets.* FAS 142 requires that goodwill be tested for

impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company s reporting unit with the reporting unit s carrying amount, including goodwill. The Company generally

determines the fair value of its reporting unit using the expected present value of future cash flows, giving consideration to the market comparable approach. If the carrying amount of the Company s reporting unit exceeds the reporting unit s fair value, the Company performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the Company s reporting unit s goodwill with the carrying amount of the unit s goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment charge is recognized for the excess. The Company determined that it has one reporting unit. The Company performed its annual test on December 1, 2005. The results of Step 1 of the goodwill impairment analysis showed that goodwill was not impaired as the estimated market value of its one reporting unit exceeded its carrying value, including goodwill. Accordingly, Step 2 was not performed. The Company will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company s reporting unit below its carrying amounts.

Revenue Recognition

The Company s revenue is derived principally from the sale of premium online subscription services, magazine subscriptions, banner and sponsorship advertisements, magazine advertisements and transactions services. Premium online subscription services are generally for a period of one to twelve months. Premium online subscription services are generally paid for upfront by credit card, subject to cancellations by subscribers or charge backs from transaction processors. Revenue, net of estimated cancellations and charge backs, is recognized ratably over the service term. To date, cancellations and charge backs have not been significant and have been within management s expectations. The Company provides an estimated reserve for magazine subscription cancellations at the time such subscription revenues are recorded. In January 2006, the Company began offering its customers premium online subscription services bundled with magazine subscriptions. In accordance with EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), the Company defers subscription revenue on bundled subscription service offerings based on the pro-rata fair value of the individual premium online subscription services and magazine subscriptions.

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

Transaction service revenue generated from the sale of products held in inventory is recognized when the product is shipped, net of estimated returns. The Company also earns commissions for facilitating the sale of third party products and services which are recognized when earned based on reports provided by third party vendors or upon cash receipt if no reports are provided. In accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent,* the revenue earned for facilitating the sale of third party merchandise is reported net of cost as agent. This revenue is reported net due to the fact that though the Company receives the order and collects money from buyer, the Company is under no obligation to make payment to the third party unless payment has been received from the buyer and risk of return is also borne by the third party. The Company recognizes transaction service revenue from its event marketing and travel events services which include cruises, land tours and resort vacations, together with revenues from onboard and other activities and all associated direct costs of its event marketing and travel events services, upon the completion of events with durations of ten nights or less and on a pro rata basis for events in excess of ten nights.

Advertising

Costs related to advertising and promotion are charged to sales and marketing expense as incurred except for direct-response advertising costs which are amortized over the expected life of the subscription, typically a twelve month period. Direct-response advertising costs consist primarily of production costs associated with direct-mail promotion of magazine subscriptions. As of December 31, 2005 and June 30, 2006, the balance of unamortized direct-response advertising costs was $173,000 and $1,325,000, respectively, and is included in prepaid expenses and other current assets. Total advertising costs in the three months ended June 30, 2005 and 2006 were $911,000 and $875,000, respectively. Total advertising costs in the six months ended June 30, 2005 and 2006 were $1,520,000 and $1,786,000, respectively.

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Equity Incentive Plans

The Company has equity incentive plans for directors, officers, employees and non-employees. Stock options granted under these plans generally vest over two to four years, are generally exercisable at the date of grant with unvested shares subject to repurchase by the Company and expire within 10 years from the date of grant. As of June 30, 2006, the Company has reserved an aggregate of approximately 3,241,000 shares of common stock for issuance under its equity incentive plans.

Stock-Based Compensation

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

The Company adopted FAS 123R using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The Company s consolidated financial statements as of and for the six months ended June 30, 2006 reflect the impact of adopting FAS 123R. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123R.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the condensed consolidated statement of operations during the three and six months ended June 30, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 148, *Accounting for Stock-based Compensation Transition and Disclosure (as amended)* (FAS 148) and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123R. As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and six months ended June 30, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under FAS 148 for the periods prior to 2006, we accounted for forfeitures as they occurred. When estimating forfeitures, the Company considers historic voluntary termination behaviors as well as trends of actual option forfeitures. In anticipation of the impact of adopting FAS 123R, the Company accelerated the vesting of approximately 720,000 shares subject to outstanding stock options in December 2005. The primary purpose of the acceleration of vesting was to minimize the amount of compensation expense recognized in relation to the options in future periods following the adoption by the Company of FAS 123R. Since the Company accelerated these shares, the impact of adopting FAS 123R was not material, to date, to the Company s results of operations.

Prior to the adoption of FAS 123R, the Company provided the disclosures required under FAS 123, as amended by FAS 148. Employee stock-based compensation expense recognized under FAS 123R was not reflected in the Company s results of operations for the three and six months ended June 30, 2005 for employee stock option awards that were granted with an exercise price equal to the market value of the underlying common stock on the date of grant.

The pro forma information for the three and six months ended June 30, 2005 required under FAS 123 was as follows (in thousands, except per share amounts):

	Three months ended June 30, 2005	Six months ended June 30, 2005
Net income, as reported:	$ 1,010	$ 1,189
Add: Employee stock-based compensation expense included in reported net income, net of tax	141	118
Less: Total employee stock-based compensation expense determined under fair value, net of tax	(316)	(401)
Pro forma net income	$ 835	$ 906
Net income per share		
As reported basic	$ 0.06	$ 0.07
As reported diluted	$ 0.06	$ 0.07
Pro forma basic	$ 0.05	$ 0.05
Pro forma diluted	$ 0.05	$ 0.05

Prior to adopting FAS 123R, the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in its statement of cash flows. FAS 123R requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. During the three and six months ended June 30, 2006, the Company has not recognized a material amount of excess tax benefits for deductions of disqualifying dispositions of such options.

The Company calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for each respective period:

	Six months ended June 30,	
	2005	2006
Expected lives (in years)	5	7
Risk free interest rates	3.59 - 4.13%	4.32 - 4.57%
Dividend yield	0%	0%
Volatility	85%	75%

The Company s computation of expected volatility for the six months ended June 30, 2006 is based on a combination of historical and market-based implied volatility from other equities comparable to the Company s stock. The Company s computation of expected life in 2006 was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes activity under our equity incentive plans for the six months ended June 30, 2006 (in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	2,112	$ 5.03		
Granted	48	9.08		
Exercised	(79)	3.85		
Cancelled	(73)	7.08		
Outstanding at June 30, 2006	2,008	5.10	3.95	$ 3,824
Vested and expected to vest at June 30, 2006	1,997	5.07	3.92	$ 3,749
Options exercisable at June 30, 2006	1,939	5.00	3.77	$ 3,874

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 1,040,000 options that were in the money at June 30, 2006. During the three and six months ended June 30, 2006, the aggregate intrinsic value of options exercised under our stock option plans was approximately $144,000 and $424,000, respectively. As of June 30, 2006, there was approximately $926,000 of total unrecognized compensation related to unvested stock-based compensation arrangements granted under the Company s equity incentive plans. That cost is expected to be recognized over a weighted-average period of four years.

Restricted Stock Grants

In January 2006, the Company granted 2,500 shares of restricted stock to a certain employee at no cost to the employee. Each restricted stock share represents one share of the Company s common stock, with the same voting and dividend rights as the Company s other outstanding common stock. The restricted stock shares vest over a period of four years with 25% vested on the anniversary date of the grant and 1/48 th vesting each month thereafter. Unearned stock-based compensation related to the restricted shares is determined based on the fair value of the Company s stock on the date of grant, which was approximately $21,000 and will be amortized to expense on a straight-line basis over the vesting period of which approximately $1,000 and $2,000 was recognized during the three and six months ended June 30, 2006, respectively.

Pursuant to the Outside Director Compensation Program adopted by the board of directors in December 2005, each non-employee director received an automatic annual grant of 2,000 shares of restricted stock on June 14, 2006, the date of the Company s annual meeting of stockholders. A total of 10,000 shares of restricted stock were granted and will vest quarterly over a one year period from the date of grant with 25% of the restricted shares vesting on the first day after the date of grant on which the Company s trading window opens pursuant to the Company s Insider Trading Policy during each fiscal quarter, unless the trading window does not open during a quarter, in which case such restricted shares will vest on the last business day immediately preceding the 16th day of the last month of that quarter. Unearned stock-based compensation related to the restricted shares is determined based on the fair value of the Company s stock on the date of grant, which was approximately $67,000 and will be amortized to expense on a straight-line basis over the vesting period of which zero was recognized during the six months ended June 30, 2006.

A summary of the status and changes of the Company s unvested shares related to its equity incentive plans as of and during the six months ended June 30, 2006 is presented below (in thousands, except per share amounts):

	Weighted Average

	Shares	Grant-Date Fair Value
Unvested at January 1, 2006		$
Granted	13	6.98
Unvested at June 30, 2006	13	6.98

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Net Income (Loss) Per Share

Basic income (loss) per share is computed by dividing net income (loss) by the sum of the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share gives effect to all dilutive potential common shares outstanding during the period. The computation of diluted net income (loss) per share does not assume conversion, exercise or contingent exercise of securities that would have an anti-dilutive effect on earnings. The dilutive effect of outstanding stock options and warrants is computed using the treasury stock method.

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
Numerator:				
Net income (loss)	$ 1,010	$ (342)	$ 1,189	$ (474)
Denominator:				
Weighted-average shares	17,092	17,315	17,015	17,288
Effect of dilutive securities:				
Dilutive common stock equivalents	1,157		1,177	
Dilutive potential common shares	1,157		1,177	
	18,249	17,315	18,192	17,288
Net income (loss) per share:				
Basic	$ 0.06	$ (0.02)	$ 0.07	$ (0.03)
Diluted	$ 0.06	$ (0.02)	$ 0.07	$ (0.03)

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

	Six months ended June 30,	
	2005	2006
Common stock options and warrants	741	2,008
Common stock subject to repurchase	2	
	743	2,008

Segment Reporting

The Company operates in one segment in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information,* (FAS 131). Although the chief operating decision maker does review revenue

results across the three revenue streams of advertising, subscription and transaction services, financial reporting is consistent with the Company s method of internal reporting where the chief operating decision maker evaluates, assesses performance and makes decisions on the allocation of resources at a consolidated results of operations level. The Company has no operating managers reporting to the chief operating decision maker over components of the enterprise for which the separate financial information of revenue, results of operations and assets is available. Additionally, all business units that meet the quantitative thresholds of the standard also meet the aggregation criteria of the standard as well.

Event Marketing

In January 2006, the Company s subsidiary, PNO DSW Events, LLC, a joint venture, began its event marketing business. The subsidiary markets events which include a number of sub-events that occur over specific periods of four to eight days. EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities and how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. The Company s revenue recognition policies are in compliance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition* ,

EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent,* EITF 00-21 and EITF 01-14, *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred* . For the purposes of EITF 00-21, the Company considers the sub-events as part of a single accounting unit and recognizes the revenue and related direct costs upon completion of the final sub-event of the accounting unit.

Recognition of revenues and expenses are deferred until completion of the final sub-event of the respective defined accounting unit. As of June 30, 2006, the Company has recorded deferred revenue of $7,000 related to event marketing and $8,000 of prepaid direct costs of event marketing included in prepaid expenses and other current assets.

Variable Interest Entities

In December 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 46 (revised December 2003) (FIN 46-R), *Consolidation of Variable Interest Entities,* which addresses accounting and disclosure requirements for variable interest entities (VIEs). FIN 46-R defines a VIE as a corporation, partnership, limited liability company, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting or similar rights sufficient to enable such investors to make decisions about an entity s activities or (b) has equity investors that do not provide sufficient financial resources to support the entities activities without additional financial support from other parties. FIN 46-R requires a VIE to be consolidated by a company if the company is subject to, among other things, a majority of the risk or residual returns of the VIE. A company that consolidates a VIE is referred to as the *primary beneficiary* under FIN 46-R. In addition, FIN 46-R requires disclosure, but not consolidation, of those entities in which the Company is not the primary beneficiary but has a significant variable interest. The consolidation and disclosure provisions of FIN 46-R became effective for reporting periods ending after March 15, 2004.

Management has reviewed its operations to determine the entities that the Company is required to consolidate under FIN 46-R. As a result of this review, the Company has determined that its interest in PNO DSW Events, LLC, a joint venture, qualifies as a variable interest entity as defined in FIN 46-R and that the Company is the primary beneficiary of the joint venture. The Company entered into the joint venture in January 2006. Under the terms of the joint venture agreement, the Company contributed an initial investment of $250,000 and acquired a 50% interest in the joint venture. Accordingly, the financial statements of the joint venture have been consolidated into the Company s condensed consolidated financial statements. The creditors of the joint venture have no recourse to the general credit of the Company. The minority interest s share of income for the three and six months ended June 30, 2006 totaled zero and $47,000, respectively. The minority interest s share of accumulated income at December 31, 2005 and June 30, 2006 was zero and $47,000, respectively.

Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154 (FAS 154), *Accounting Changes and Error Corrections,* which replaces APB Opinion No. 20, *Accounting Changes,* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements,* and changes the requirements for the accounting for and reporting of a change in accounting principle. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of FAS 154 in the three months ended March 31, 2006 did not have a material effect on the Company s results of operations, liquidity or capital resources.

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109*"(FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. This interpretation is effective on January 1, 2007 for PlanetOut and the Company is currently in the process of evaluating the impact of this interpretation on its consolidated financial statements.

Note 3 Business Combinations, Goodwill and Intangible Assets

RSVP Productions Inc. Acquisition

In March 2006, the Company acquired substantially all of the assets of RSVP, a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. The purchase agreement entitles RSVP to receive potential additional earn-out payments of up to $3,000,000 based on certain revenue and net income milestones for each of the years ending December 31, 2007 and December 31, 2008. These earn-out payments, if any, will be paid no later than March 15, 2008 and March 15, 2009,

respectively, and may be paid in either cash or shares of the common stock of the Company, at the Company s discretion.

The preliminary purchase price allocation is as follows (in thousands):

Cash	$ 1,289
Other current assets	4,987
Fixed assets, net	116
Definite lived intangible assets:	
Customer relationships	1,810
Indefinite lived intangible assets:	
Tradenames	940
Goodwill	3,982
Accounts payable and other current liabilities	(60)
Deferred revenue	(6,395)
Total preliminary purchase price	$ 6,669

Supplemental consolidated information on an unaudited pro forma consolidated basis, as if the RSVP acquisition was completed at the beginning of the years 2005 and 2006, is as follows (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
	(Unaudited)		(Unaudited)	
Revenue	$ 8,549	$ 16,295	$ 18,917	$ 35,583
Net income (loss)	$ 368	$ (354)	$ 690	$ (986)
Basic income (loss) per share	$ 0.02	$ (0.02)	$ 0.04	$ (0.06)

Goodwill

The following table presents goodwill balances and the adjustments to the Company s acquisitions during the six months ended June 30, 2006 (in thousands):

Acquisition	December 31, 2005	Goodwill Acquired	Adjustments	June 30, 2006
Acquisitions prior to December 31, 2004	$ 3,403	$	$	$ 3,403
LPI	25,296		(109)	25,187
RSVP		3,982		3,982
	$ 28,699	$ 3,982	$ (109)	$ 32,572

Adjustments to goodwill during the six months ended June 30, 2006 resulted primarily from purchase price adjustments related to transaction costs and deferred revenue.

In accordance with FAS 142, goodwill is subject to at least an annual assessment for impairment, applying a fair-value based test. The Company conducts its annual impairment test as of December 1 of each year. Based on the Company s last impairment test as of December 1, 2005, the Company determined there was no impairment. There were no events or circumstances from that date through June 30, 2006 indicating that a further assessment was

necessary.

Intangible Assets

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

	December 31, 2005			June 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)			(In thousands)		
Intangible assets:						
Customer lists and user bases	$ 8,678	$ 3,469	$ 5,209	$ 10,488	$ 4,194	$ 6,294
Tradenames	8,040	2,340	5,700	8,980	2,340	6,640
Other intangible assets	726	726		726	726	
	$ 17,444	$ 6,535	$ 10,909	$ 20,194	$ 7,260	$ 12,934

Intangible assets subject to amortization consist primarily of customer lists and user bases with amortization periods of two to six years.

As of June 30, 2006, expected future intangible asset amortization is as follows (in thousands):

Fiscal Years:	
2006 (remaining six months)	$ 802
2007	1,423
2008	1,396
2009	1,257
2010	1,093
Thereafter	323
	$ 6,294

Note 4 Other Balance Sheet Components

	December 31, 2005	June 30, 2006
	(In thousands)	
Accounts receivable:		
Trade accounts receivable	$ 7,033	$ 9,464
Less: Allowance for doubtful accounts	(259)	(441)
Less: Provision for returns	(744)	(1,184)
	$ 6,030	$ 7,839

In the three months ended June 30, 2005 and 2006, the Company provided for an increase in the allowance for doubtful accounts of $20,000 and $488,000 respectively, and wrote-off accounts receivable against the allowance for doubtful accounts totaling $24,000 and $519,000, respectively. In the six months ended June 30, 2005 and 2006, the Company provided for an increase in the allowance for doubtful accounts of $26,000 and $905,000 respectively, and wrote-off accounts receivable against the allowance for doubtful accounts totaling $24,000 and $723,000, respectively.

Prior to the acquisition of LPI in November 2005, the Company estimated a provision for returns of zero based on its historical returns. In the three months ended June 30, 2006, the Company provided for an increase in the provision for returns of $1,178,000, and wrote-off accounts receivable against the provision for returns totaling $1,114,000. In the six months ended June 30, 2006, the Company provided for an increase in the provision for returns of $2,319,000, and wrote-off accounts receivable against the provision for returns totaling $1,879,000.

	December 31, 2005	June 30, 2006
	(In thousands)	
Inventory:		
Materials for future publications	$ 415	$ 347
Finished goods available for sale	1,019	1,139
	1,434	1,486
Less: reserve for obsolete inventory	(85)	(96)
	$ 1,349	$ 1,390

Prior to the acquisition of LPI in November 2005, the Company estimated a provision for obsolete inventory of zero based on its historical valuation of inventory. In the three months ended June 30, 2006, the Company provided for an increase in the provision for obsolete inventory of $9,000, and wrote-off inventory against the reserve for obsolete inventory totaling $3,000. In the six months ended June 30, 2006, the Company provided for an increase in the reserve for obsolete inventory of $16,000, and wrote-off inventory against the reserve for obsolete inventory totaling $5,000.

	December 31, 2005	June 30, 2006
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid expenses and other current assets	$ 2,328	$ 4,349
Deposits on leased voyages		5,707
Receivable from landlord for tenant improvement allowance, current portion (Note 2)	243	
	$ 2,571	$ 10,056

	December 31, 2005	June 30, 2006
	(In thousands)	
Property and equipment:		
Computer and network equipment	$ 7,879	$ 8,878
Furniture and fixtures	1,396	1,568
Computer software	2,523	2,625
Leasehold improvements	1,555	1,537
Capitalized software and website development costs	4,783	5,521
	18,136	20,129
Less: Accumulated depreciation and amortization	(9,969)	(11,680)
	$ 8,167	$ 8,449

During the three months ended June 30, 2005 and 2006, depreciation and amortization expense of property and equipment was $848,000 and $899,000, respectively. During the six months ended June 30, 2005 and 2006, depreciation and amortization expense of property and equipment was $1,668,000 and $1,798,000, respectively.

	December 31, 2005	June 30, 2006
	(In thousands)	
Other assets:		
Other assets	$ 921	$ 926
Deposits on leased voyages		676
Interest on note receivable from stockholder (Note 5)	231	
	$ 1,152	$ 1,602

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	December 31, 2005	June 30, 2006
	(In thousands)	
Accrued liabilities:		
Accrued payroll and related liabilities	$ 989	$ 1,302
Other accrued liabilities	1,761	2,014
	$ 2,750	$ 3,316

Note 5 Related Party Transaction

In May 2001, the Company issued a promissory note to an executive of the Company for $603,000 to fund the purchase of Series D redeemable convertible preferred stock. The principal and interest were due and payable in May 2006. Interest accrued at a rate of 8.5% per annum or the maximum rate permissible by law, whichever was less and was full recourse. The note was full recourse with respect to $24,000 in principal payment and the remainder of the principal was non-recourse. The note was collateralized by the shares of common stock and options owned by the executive. Interest income of $13,000 and zero was recognized in the three months ended June 30, 2005 and 2006, respectively. Interest income of $26,000 and $9,000 was recognized in the six months ended June 30, 2005 and 2006, respectively. In March 2006, the executive repaid the Company approximately $843,000, representing approximately $603,000 in principal and approximately $240,000 in accrued interest, fully satisfying the repayment obligations.

Note 6 Notes Payable

In November 2004, the Company entered into a software maintenance agreement under which $332,000 was financed with a vendor. This amount was payable in seven quarterly installments beginning in January 2005. The note was paid in full in June 2006.

In November 2005, the Company issued a note payable in connection with its acquisition of the assets of LPI in the amount of $7,075,000 to the sellers, secured by the assets of SpecPub, Inc. (a subsidiary of the Company established to hold certain such assets) and payable in three equal installments of $2,358,000 in May, August and November 2007. The note bears interest at a rate of 10% per year, payable quarterly and in arrears. For the three and six months ended June 30, 2006, the Company recorded interest expense on the note of $177,000 and $354,000, respectively, in the condensed consolidated statements of operations. As of June 30, 2006, $2,358,000 is included in notes payable, current portion and $4,716,000 is included in long-term notes payable.

In December 2005, the Company entered into a payment plan agreement with a vendor to finance a purchase of system software in the amount of $82,000. This amount is payable in four quarterly installments beginning in January 2006. As of December 31, 2005 and June 30, 2006, $82,000 and $21,000, respectively, is included in notes payable, current portion.

In June 2006, the Company entered into a software maintenance agreement under which $90,000 was financed with a vendor. This amount is payable in four quarterly installments beginning in July 2006. As of June 30, 2006, $67,000 is included in notes payable, current portion.

Note 7 Commitments and Contingencies

Deposit Commitments

The Company enters into leasing agreements with cruise lines which establish varying deposit commitments as part of the lease agreement prior to the commencement of the leased voyage. At June 30, 2006, the Company had deposits on leased voyages of $5,707,000 included in prepaid expenses and other current assets, long-term deposits on leased voyages of $676,000 included in other assets and commitments for future deposits of $14,009,000, of which $4,633,000 is secured by restricted cash pursuant to a contractual agreement associated with an irrevocable letter of credit. Approximately $2,050,000 of the restricted cash will be applied against the commitments for future deposits during the remainder of 2006 and approximately $2,583,000 of the restricted cash will be applied against the commitments for future deposits in March 2007.

Contingencies

The Company is not currently subject to any material legal proceedings. The Company may from time to time, however, become a party to various legal proceedings, arising in the ordinary course of business. The Company may also be indirectly affected by administrative or court proceedings or actions in which the Company is not involved but which have general applicability to the Internet industry. The Company is currently involved in the matter discussed below. However, the Company does not believe, based on current knowledge, that this matter is likely to have a material adverse effect on its financial position, results of operations or cash flows.

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In April 2002, the Company was notified that DIALINK, a French company, had filed a lawsuit in France against it and its French subsidiary, alleging that the Company had improperly used the domain names Gay.net, Gay.com and fr.gay.com in France, as DIALINK alleges that it has exclusive rights to use the word gay as a trademark in France. On June 30, 2005, the French court found that although the Company had not infringed DIALINK s trademark, it had damaged DIALINK through unfair competition.

The Court ordered the Company to pay damages of 50,000 (US $63,000 at June 30, 2006), half to be paid notwithstanding appeal, the other half to be paid after appeal. The Court also enjoined the Company from using gay as a domain name for its services in France. In October 2005, the Company paid half the damage awarded as required by the court order and temporarily changed the domain name of its French website, from www.fr.gay.com to www.ooups.com, a domain name it has used previously in France. The Company has accrued the full damage award and in January 2006 appealed the French court s decision. DIALINK s reply brief to the Company s appeal is due to be filed by August 30, 2006.

Note 8 Restructuring

On June 29, 2006, the board of directors of the Company adopted and approved a reorganization plan to align the Company s resources with its strategic business objectives. As part of the plan, the Company consolidated its media and advertising services, e-commerce services and back-office operations on a global basis to streamline its operations as part of continued integration of its recently acquired businesses. The reorganization, along with other organizational changes, reduced the Company s total workforce by approximately 5%. Restructuring costs of approximately $834,000, primarily related to termination benefits of approximately $631,000 and the cost of closing redundant facilities of approximately $203,000, were recorded during the three months ended June 30, 2006. The Company expects to be able to complete this restructuring in the third quarter of 2006, with certain payments continuing beyond the third quarter of 2006 in accordance with the terms of existing severance and other agreements and with some aspects of facilities consolidation potentially continuing into the fourth quarter of 2006.

The following is a summary of the restructuring activities:

	Initial Restructuring Charges	Cash Payments	Write-offs	Accrued Restructuring As of June 30, 2006
	(In thousands)			
Termination benefits	$ 631	$	$	$ 631
Cost of closing redundant facilities	203		(41)	162
Total	$ 834	$	$ (41)	$ 793

Note 9 Subsequent Events

In July 2006, the Company entered into an amendment to a facility lease agreement to expand its facilities in Los Angeles and also entered into an agreement to sublease a portion of its facilities in New York. These transactions were executed as part of the Company s continued integration of its recently acquired businesses.

In July 2006, the Company granted 90,000 shares of restricted stock to the Company s newly appointed Chief Executive Officer pursuant to the employment agreement executed in June 2006. The shares will vest in four equal annual installments with 1/4th of the shares vesting following each of the anniversaries of the appointment.

In August 2006, the Company amended and restated the employment agreement with its President and Chief Operating Officer. Under the terms of this agreement, the Company increased the annual base compensation, provided for a retention bonus of $280,000 payable if he is employed by the Company on December 31, 2006 and granted 40,000 shares of restricted stock. With respect to the restricted stock grant, 10,000 shares of restricted stock will vest in January 2007 and 5,000 shares of restricted stock will vest each July and January thereafter through January 2010.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the financial statements and related notes which appear elsewhere in this document. This discussion contains forward-looking statements that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terminology including would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential or continue, the negative of these terms or other comparable terminology. These statements are only predictions. Forward-looking statements include statements about our business strategy, future operating performance and prospects. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this document and in our Form 10-K filed for the year ended December 31, 2005.

Overview

We are a leading global media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender (LGBT) community. Our products and services, including travel and events from RSVP Productions, Inc. (RSVP), and our network of media properties, including our flagship websites Gay.com and PlanetOut.com, and *The Advocate* and *Out* magazines, allow our members to connect with and learn about other members of the LGBT community around the world.

With our November 2005 acquisition of substantially all of the assets of LPI Media Inc. and related entities (LPI), we expanded the number and scope of our subscription service offerings. In addition to premium subscriptions to our Gay.com and PlanetOut.com services, we offer our customers subscriptions to eight other online and print products and services, as well as to various combined, or bundled, packages of these subscription services, including the leading LGBT-targeted magazines in the United States, *Out* and *The Advocate*. We believe *Out* magazine is the leading audited circulation magazine in the United States focused on the gay and lesbian community, while *The Advocate,* a pioneer in LGBT media since 1967, is the second largest. We believe these, and other properties acquired from LPI, allow us to better serve our business and consumer customers by expanding the platforms and content that we can provide them and to more cost-effectively promote our own products and services.

On March 4, 2006, we completed the purchase of substantially all of the assets of RSVP, a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. Through RSVP, we will be able to offer specialized travel and event packages to the LGBT market. Typically, RSVP develops travel itineraries on land, at resorts, and on cruises, by contracting with third-parties who provide the basic travel services. To these basic services, RSVP frequently adds additional programming elements, such as special entertainers, parties and events, and markets these enhanced vacation packages to the gay and lesbian audience.

These acquisitions support our strategic plan of building a diversified global media and entertainment company serving the LGBT community, growing our revenue base and diversifying our revenue mix among advertising services, subscription services and transaction services.

On June 29, 2006, our board of directors adopted and approved a reorganization plan to align our resources with our strategic business objectives. As part of the plan, we consolidated our media and advertising services, e-commerce services and back-office operations on a global basis to streamline our operations as part of continued integration of our recently acquired businesses. The reorganization, along with other organizational changes, reduced our total workforce by approximately 5%. Restructuring costs of approximately $0.8 million, primarily related to employee severance benefits of approximately $0.6 million and facilities consolidation expenses of approximately $0.2 million, were recorded during the three months ended June 30, 2006. We expect to be able to complete this restructuring in the third quarter of 2006, with certain payments continuing beyond the third quarter of 2006 in accordance with the terms of existing severance and other agreements and with some aspects of facilities consolidation potentially continuing into the fourth quarter of 2006.

Although we had positive net income in the year ended December 31, 2005, we had a net loss of $0.5 million for the six months ended June 30, 2006 and we have incurred significant losses since our inception. As of June 30, 2006, we had an accumulated deficit of $35.1 million. We expect to incur significant marketing, engineering and technology, and general and administrative expenses for the foreseeable future. As a result, we will need to continue

to grow revenue and increase our operating margins to regain and expand our profitability.

Results of Operations

The following table sets forth the percentage of total revenue represented by items in our condensed consolidated statements of operations:

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	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
	(As a percentage of total revenue; unaudited)			
Consolidated statements of operations data:				
Revenue:				
Advertising services	31.8%	44.9%	26.9%	37.4%
Subscription services	64.1	38.8	68.0	37.2
Transaction services	4.1	16.3	5.1	25.4
Total revenue	100.0	100.0	100.0	100.0
Operating costs and expenses:				
Cost of revenue	28.7	42.2	30.2	48.1
Sales and marketing	31.4	27.2	33.9	24.7
General and administrative	20.0	18.8	19.4	18.2
Restructuring		5.1		2.5
Depreciation and amortization	10.5	8.0	11.3	7.4
Total operating costs and expenses	90.6	101.3	94.8	100.9
Income (loss) from operations	9.4	(1.3)	5.2	(0.9)
Equity in net loss of unconsolidated affiliate	(0.2)		(0.2)	
Interest expense	(0.4)	(1.2)	(0.5)	(1.2)
Other income, net	3.9	0.6	3.9	0.8
Income (loss) before income taxes and minority interest	12.7	(1.9)	8.4	(1.3)
Provision for income taxes	(0.2)		(0.3)	
Minority interest in gain of consolidated affiliate		(0.3)		(0.1)
Net income (loss)	12.5%	(2.2)%	8.1%	(1.4)%

Summary

Total revenue was $16.3 million in the three months ended June 30, 2006, increasing 102% above total revenue of $8.1 million in the three months ended June 30, 2005. Total revenue was $33.9 million in the six months ended June 30, 2006, increasing 130% above total revenue of $14.7 million in the six months ended June 30, 2005. These increases were primarily due to the incremental effect of the acquisitions of LPI and RSVP.

Total operating costs and expenses were $16.5 million in the three months ended June 30, 2006, 126% above operating costs and expenses of $7.3 million in the three months ended June 30, 2005. Total operating costs and

expenses were $34.2 million in the six months ended June 30, 2006, 145% above operating costs and expenses of $14.0 million in the six months ended June 30, 2005. These increases were primarily due to the incremental effect of the acquisitions of LPI and RSVP, expenses related to the adoption of the restructuring plan in June 2006, and increases in marketing expenses, occupancy expenses related to the expansion of our corporate headquarters in January 2006 and acquisition-related expenses.

Loss from operations was $0.2 million in the three months ended June 30, 2006, compared to income from operations of $0.8 million in the three months ended June 30, 2005. Loss from operations in the three months ended June 30, 2006 includes restructuring expenses of $0.8 million. Loss from operations was $0.3 million in the six months ended June 30, 2006, compared to income from operations of $0.8 million in the six months ended June 30, 2005. This decrease was primarily related to the restructuring expenses in the second quarter of 2006 and, to a lesser extent, expenses related to the acquisition and integration of LPI and RSVP, and the effect of the international *gratis* campaign which was launched in October 2005. As part of this campaign, we offer our online premium services free of charge in some international markets. While this campaign has increased our marketing expenses and reduced the growth in our subscription services revenue, and therefore resulted in decreased operating margins in the international sector, it is intended to grow critical mass in international markets and lay the foundation for future international revenue growth from our family of media and entertainment properties.

Management anticipates that revenue will continue to increase for the remainder of fiscal 2006 over fiscal 2005, primarily as a result of the anticipated incremental effects of the acquisitions of LPI and RSVP.

We expect our operating income will increase for the remainder of fiscal 2006 as we realize additional operating efficiencies through the integration of our acquired businesses. For the remainder of 2006, we anticipate that these gains in operating efficiencies will continue to be partially offset by non-recurring acquisition and business integration costs, higher expenses to launch new member facing features in our online products and higher depreciation and amortization related to the acquisitions of LPI and RSVP and the development of these online member facing features.

Revenue

Advertising Services. We derive online advertising revenue from advertising contracts in which we typically undertake to deliver a minimum number of impressions to users over a specified time period for a fixed fee. In addition to revenue from advertisers who place general online advertisements on our websites, we derive advertising revenue from the sale of online classified listings and from print advertising. Advertising services revenue was $7.3 million in the three months ended June 30, 2006, an increase of 185% from the three months ended June 30, 2005. We had advertising services revenue of $12.7 million in the six months ended June 30, 2006, an increase of 220% from the six months ended June 30, 2005. This improvement was due, in part, to growth of the general online advertising industry and the incremental effect of the acquisition of LPI. During the first six months of 2006, we expanded our Local Scene listings on our websites, a local business listing directory intended to drive local business advertising opportunities. Advertising services revenue accounted for 45% of revenue for the three months ended June 30, 2006, up from 32% for the three months ended June 30, 2005. Advertising services revenue accounted for 37% of revenue for the six months ended June 30, 2006, up from 27% for the six months ended June 30, 2005.

For the remainder of fiscal 2006, we expect advertising services revenue to continue to increase over fiscal 2005, in both absolute dollars and as a percentage of our overall revenue as a result of both our planned growth and the effects of the acquisition of LPI.

Subscription Services. We offer our customers ten separate subscription services across both our online and print media properties. In addition, we have developed new bundled packages of our various subscription services to increase their value to our customers and to generate subscribers, circulation and revenue. Our subscription services revenue was $6.3 million in the three months ended June 30, 2006, an increase of 22% from the three months ended June 30, 2005. Our subscription services revenue was $12.6 million in the six months ended June 30, 2006, an increase of 26% from the six months ended June 30, 2005. These increases were due to the incremental effect of the acquisition of LPI, partially offset by a reduction in online subscribers. The development of new bundled packages has resulted in an increase in our print media subscriber base of over 5% during the three months ended June 30, 2006. For the three months ended June 30, 2006, subscription services revenue accounted for 39% of revenue, down from 64% for the three months ended June 30, 2005. For the six months ended June 30, 2006, subscription services revenue accounted for 37% of revenue, down from 68% for the six months ended June 30, 2005. The decreases in subscription services revenue as a percentage of total revenue occurred as a result of the higher growth rate of our advertising services, the international *gratis* campaign, and the acquisitions of LPI and RSVP.

For fiscal 2006, we expect total subscription services revenue to increase over fiscal 2005, supported by service enhancements and new product and service introductions, partially offset by the continuation of the international *gratis* campaign. At the same time, however, we expect the percentage of our overall revenue attributable to subscription services to decrease as a result of even higher growth in our advertising and transaction service lines associated, in part, with the acquisitions of LPI and RSVP.

Transaction Services. Transaction services revenue includes revenue generated from the sale of products through multiple e-commerce websites, sales of magazines through newsstand circulation, book sales, travel events and event marketing. Travel events services include cruises, land tours and resort vacations, together with revenues from onboard and other activities. Our transaction services revenue totaled $2.7 million in the three months ended June 30, 2006, an increase of 700% from the three months ended June 30, 2005. Transaction services revenue totaled $8.6 million in the six months ended June 30, 2006, an increase of 1045% from the six months ended June 30, 2005. These increases were primarily due to the incremental effect of the acquisitions of LPI and RSVP as well revenue generated during the three months ended June 30, 2006 by *The Dinah,* the first event sponsored by our joint venture,

PNO DSW Events, LLC. Transaction services revenue accounted for 16% of revenue for the three months ended June 30, 2006, up from 4% for the three months ended June 30, 2005. Transaction services revenue accounted for 25% of revenue for the six months ended June 30, 2006, up from 5% for the six months ended June 30, 2005.

The travel and event marketing business has long lead times, and revenue is recorded when cruises or events are delivered. Our transaction services revenue will fluctuate from quarter to quarter depending upon the timing of scheduled cruises and events. For the remainder of fiscal 2006, we expect transaction services revenue to increase over fiscal 2005, and the percentage of our revenue

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attributable to transaction services revenue to increase as a result of the acquisitions of LPI and RSVP.

Operating Costs and Expenses

Cost of Revenue. Cost of revenue primarily consists of payroll and related benefits associated with supporting our subscription-based services, product engineering of our online properties and producing and maintaining content for our various websites, magazines and newsletters. Other expenses directly related to generating revenue included in cost of revenue include commissions and other expenses related to travel events services, transaction processing fees, computer equipment maintenance, occupancy costs, co-location and Internet connectivity fees, purchased content and cost of goods sold. Cost of revenue was $6.9 million in the three months ended June 30, 2006, an increase of 196% from the three months ended June 30, 2005. Cost of revenue was $16.3 million in the six months ended June 30, 2006, an increase of 267% from the six months ended June 30, 2005. These increases were due to the incremental effect of the acquisitions of LPI and RSVP, increases in employee headcount and salaries and higher occupancy expenses related to the expansion of our corporate headquarters, offset partially by decreases in stock-based compensation expense and referral fees. Cost of revenue was 42% as a percentage of total revenue for the three months ended June 30, 2006, up from 29% in the three months ended June 30, 2005. Cost of revenue was 48% as a percentage of total revenue for the six months ended June 30, 2006, up from 30% in the six months ended June 30, 2005. These increases were due to the incremental effect of the acquisitions of LPI and RSVP and an increase in product engineering expenses in support of our product development efforts.

For the remainder of fiscal 2006, we expect cost of revenue to increase over fiscal 2005 as we continue to invest in human resources and other areas in support of our strategic growth plan, and due to the acquisitions of LPI and RSVP. We expect the cost of revenue as percentage of revenue to increase for the remainder of 2006 over fiscal 2005 as a result of the shift in our revenue mix resulting from the acquisitions of LPI and RSVP.

Sales and Marketing. Sales and marketing expense primarily consists of payroll and related benefits for employees involved in sales, client service, customer service, marketing and other support functions; product, service and general corporate marketing and promotions; and occupancy costs. Sales and marketing expenses were $4.4 million in the three months ended June 30, 2006, an increase of 75% from the three months ended June 30, 2005. Sales and marketing expenses were $8.4 million in the six months ended June 30, 2006, an increase of 68% from the six months ended June 30, 2005. These increases were due to the incremental effect of the acquisitions of LPI and RSVP and increases in employee headcount and salaries, partially offset by decreased advertising expenses related to our premium subscription services. Sales and marketing expenses as a percentage of revenue were 27% for the three months ended June 30, 2006, down from 31% in the three months ended June 30, 2005. Sales and marketing expenses as a percentage of revenue were 25% for the six months ended June 30, 2006, down from 34% in the six months ended June 30, 2005. These decreases occurred primarily as a result of the effect of the acquisitions of LPI and RSVP.

For the remainder of fiscal 2006, we expect sales and marketing expenses to increase over fiscal 2005 due to the incremental costs of selling and marketing the LPI and RSVP products and services. We expect sales and marketing expense as a percentage of revenue to decrease as we begin to leverage operating synergies from our historical business and our acquisitions of LPI and RSVP.

General and Administrative. General and administrative expense consists primarily of payroll and related benefits for executive, finance, administrative and other corporate personnel, occupancy costs, professional fees, insurance and other general corporate expenses. General and administrative expenses were $3.1 million for the three months ended June 30, 2006, an increase of 91% from the three months ended June 30, 2005. General and administrative expenses were $6.2 million for the six months ended June 30, 2006, an increase of 115% from the six months ended June 30, 2005. These increases were due to the incremental effect of the acquisitions of LPI and RSVP, increased compensation and employee related costs as a result of increases in headcount, integration and other expenses associated with the acquisitions of LPI and RSVP and higher occupancy expenses related to the expansion of our corporate headquarters, partially offset by a decrease in stock-based compensation expense. General and administrative expenses as a percentage of revenue were 19% for the three months ended June 30, 2006, down from 20% in the three months ended June 30, 2005. General and administrative expenses as a percentage of revenue were 18% for the six months ended June 30, 2006, down from 19% in the six months ended June 30, 2005. These decreases occurred as a result of the effect of the acquisitions of LPI and RSVP.

For the remainder of fiscal 2006, we expect general and administrative expenses to increase over fiscal 2005 as we continue to invest in human resources in support of our strategic growth plan and incur expenses associated with the integration of LPI and RSVP. We expect the percentage of our revenue attributable to general and administrative expenses to decrease as we continue to manage our expenses, see improved economies of scale and scope across multiple products, services and geographies, and begin to leverage operating synergies from our acquisitions of LPI and RSVP.

Restructuring. On June 29, 2006, our board of directors adopted and approved a reorganization plan to align our resources with our strategic business objectives. As part of the plan, we consolidated our media and advertising services, e-commerce services and back-office operations on a global basis to streamline our operations as part of continued integration of our recently acquired

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businesses. The reorganization, along with other organizational changes, reduced our total workforce by approximately 5%. Restructuring costs of approximately $0.8 million, primarily related to employee severance benefits of approximately $0.6 million and facilities consolidation expenses of approximately $0.2 million, were recorded during the three months ended June 30, 2006. We expect to be able to complete this restructuring in the third quarter of 2006, with certain payments continuing beyond the third quarter of 2006 in accordance with the terms of existing severance and other agreements and with some aspects of facilities consolidation potentially continuing into the fourth quarter of 2006.

Depreciation and Amortization. Depreciation and amortization expense was $1.3 million for the three months ended June 30, 2006, an increase of 53% from the three months ended June 30, 2005. Depreciation and amortization expense was $2.5 million for the six months ended June 30, 2006, an increase of 51% from the six months ended June 30, 2005. These increases were due primarily to an increase in the amortization of intangible assets associated with the acquisitions of LPI and RSVP and increased capital expenditures to support our on-going product development and compliance efforts. Amortization of intangible assets was $0.4 million and $0.7 million for the three and six months ended June 30, 2006, respectively, due to intangible assets which we capitalized in connection with the acquisitions of LPI and RSVP. Depreciation and amortization as a percentage of revenue was 8% for the three months ended June 30, 2006, down from 11% in the three months ended June 30, 2005. Depreciation and amortization as a percentage of revenue was 7% for the six months ended June 30, 2006, down from 11% in the six months ended June 30, 2005.

For the remainder of fiscal 2006, we expect depreciation and amortization expense will increase materially over fiscal 2005 as a result of the acquisitions of LPI and RSVP and capital investments to support our strategic growth plan.

Other Income and Expenses

Equity in Net Loss of Unconsolidated Affiliate. We recorded a net loss of unconsolidated affiliate of $16,000 and $25,000 for the three and six months ended June 30, 2005, respectively, for our 45% interest in Gay.it S.p.A. Our investment in this unconsolidated affiliate was reduced to zero as of December 31, 2005.

Interest Expense. Our interest expense was $0.2 million for the three months ended June 30, 2006, an increase of 570% from the three months ended June 30, 2005. Our interest expense was $0.4 million for the six months ended June 30, 2006, an increase of 485% from the six months ended June 30, 2005. These increases were primarily as a result of the issuance of the note payable in connection with the acquisition of LPI.

Other Income, Net. Other income, net consists of interest earned on cash, cash equivalents and restricted cash as well as other miscellaneous non-operating transactions. Our other income, net was $0.1 million for the three months ended June 30, 2006, a decrease of 65% from the three months ended June 30, 2005. Our other income, net was $0.3 million for the six months ended June 30, 2006, a decrease of 49% from the six months ended June 30, 2005. These decreases were primarily due to decreased interest income during the three and six months ended June 30, 2006 on our lower cash balance as a result of the acquisitions of LPI in November 2005 and RSVP in March 2006.

Liquidity and Capital Resources

We have historically financed our operations primarily through public and private sales of equity. During the six months ended June 30, 2006, net cash used in operating activities was $2.5 million, and was primarily attributable to increases in prepaid expenses and accounts receivable, a decrease in deferred revenue and our net loss for the period, partially offset by an increase in accrued restructuring and non-cash charges related to depreciation and amortization expense. During the six months ended June 30, 2005, net cash provided by operating activities was $3.1 million, and was primarily attributable to the growth of our advertising and premium subscription services and collection of a $1.0 million receivable for tenant improvements.

Net cash used in investing activities was $11.8 million for the six months ended June 30, 2006, and was primarily attributable to the acquisition of RSVP, an increase in restricted cash and purchases of property and equipment. Net cash used in investing activities was $2.7 million for the six months ended June 30, 2005, and was primarily attributable to purchases of hardware, software, property and equipment, including $0.5 million for capitalization of internally developed software and $0.8 million for capitalization of external product development. While we expect to continue to invest in development and infrastructure in 2006, we also expect to be able to realize tenant improvement

allowances associated with the move of our corporate headquarters in the third quarter of 2004.

Net cash provided by financing activities in the six months ended June 30, 2006 was $0.7 million and was attributable to the repayment of a note receivable from a stockholder and proceeds from the exercise of common stock options, partially offset by principal payments under capital lease obligations and notes payable. Net cash used in financing activities in the six months ended June 30, 2005 was $0.3 million and was primarily attributable to payments of capital lease obligations offset by interest income on the proceeds from our initial public offering. As of June 30, 2006, we had cash and cash equivalents of approximately $4.9 million.

On November 8, 2005, we acquired substantially all of the assets of LPI for a purchase price of approximately $32.6 million which consisted of $24.9 million paid in cash and approximately $7.1 million in the form of a note to the sellers secured by the assets of SpecPub, Inc. and payable in three equal installments in May, August and November 2007, and the reimbursement of certain prepaid and other expenses of approximately $0.6 million.

On March 4, 2006, we acquired substantially all of the assets of RSVP for a purchase price of approximately $6.6 million. The purchase agreement entitles RSVP to receive potential additional earn-out payments of up to $3.0 million payable upon certain revenue and net income milestones for each of the years ending December 31, 2007 and December 31, 2008. These earn-out payments, if any, will be paid no later than March 15, 2008 and March 15, 2009, respectively, and may be paid in either cash or shares of our common stock, at our discretion.

We enter into leasing agreements with cruise lines which establish varying deposit commitments as part of the lease agreement prior to the commencement of the leased voyage. At June 30, 2006, we had deposits on leased voyages of $5.7 million included in prepaid expenses and other current assets, long-term deposits on leased voyages of $0.7 million included in other assets and commitments for future deposits of $14.0 million. Typically, customers who book passage on these voyages are required to make scheduled deposits to us for these leased voyages. At June 30, 2006, we had deposits from customers of $4.6 million included in deferred revenue, current portion and $0.7 million included in long-term deferred revenue.

Our capital requirements depend on many factors, including growth of our revenue, the resources we devote to developing, marketing and selling our services, the timing and extent of our introduction of new features and services, the timing of deposits on leased voyages, the extent and timing of potential investments or acquisitions and other factors. In particular, our premium membership services consist of prepaid subscriptions that provide cash flows in advance of the actual provision of services. We expect to devote substantial capital resources to expand our product development and marketing efforts, to expand internationally, to complete acquisitions, joint ventures and strategic alliances and for other general corporate activities.

Based on our current operations and planned growth, we expect that our available funds and anticipated cash flows from operations will be sufficient to meet our expected needs for working capital and capital expenditures for the next twelve months. If we do not have sufficient cash available to finance our operations or potential additional acquisitions, we may be required to obtain additional public or private debt or equity financing. We cannot be certain that additional financing will be available to us on favorable terms when required or at all. If we are unable to raise sufficient funds, we may need to reduce our planned operations and expansion activities. In April 2006, we filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission for up to $75.0 million of common stock, preferred stock, debt securities and/or warrants to be sold from time to time at prices and on terms to be determined by market conditions at the time of offering. In addition, under the shelf registration statement some of our stockholders may sell up to 1.7 million shares of our common stock.

Off-balance Sheet Liabilities

We did not have any off-balance sheet liabilities as of June 30, 2006.

Other Contractual Commitments

The following table summarizes our contractual obligations as of June 30, 2006:

	Payments Due by Period				
	Total	Remainder of 2006	2007-2008	2009-2010	2011 & After
	(In thousands)				
Contractual obligations:					
Capital lease obligations	$ 852	$ 203	$ 527	$ 120	$ 2
Operating leases	15,193	1,354	5,285	5,277	3,277
Deposit commitments	14,009	4,633	9,376		
Notes payable	7,931	399	7,532		

Other	534	261	204	69	
Total contractual obligations	$ 38,519	$ 6,850	$ 22,924	$ 5,466	$ 3,279

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

Operating Leases. We lease or sublease office space and equipment under cancelable and noncancelable operating leases with various expiration dates through January 20, 2012.

Deposit Commitments. We enter into leasing agreements with cruise lines which establish varying deposit commitments as part of the lease agreement prior to the commencement of the leased voyage.

Notes payable. In November 2005, we issued a note payable in connection with our acquisition of the assets of LPI in the amount of $7,075,000, secured by the assets of SpecPub, Inc. and payable in three equal installments of $2,358,000 in May, August and November 2007. The note bears interest at a rate of 10% per year, payable quarterly and in arrears. For the three and six months ended June 30, 2006, we recorded interest expense on the note of $177,000 and $354,000, respectively.

In December 2005, we entered into a payment plan agreement with a vendor to finance a purchase of system software in the amount of $82,000. This amount is payable in four quarterly installments beginning in January 2006. As of June 30, 2006, $21,000 is included in notes payable, current portion.

In June 2006, the Company entered into a software maintenance agreement under which $90,000 was financed with a vendor. This amount is payable in four quarterly installments beginning in July 2006. As of June 30, 2006, $67,000 is included in notes payable, current portion.

Other. Other contractual obligations consist of a guaranteed executive incentive bonus and a purchase obligation for a co-location facility agreement with a third-party service provider.

Critical Accounting Policies

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

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

Except with respect to changes in the manner in which we account for share-based compensation, as discussed below, there have been no significant changes in our critical accounting policies from those listed in our Form 10-K for the fiscal year ended December 31, 2005.

Stock-based compensation. We have granted stock options to employees and non-employee directors. We recognize compensation expense for all stock-based payments granted after December 31, 2005 and prior to but not yet vested as of December 31, 2005, in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (FAS 123R). Under the fair value recognition provisions of FAS 123R, we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award (normally the vesting period). Prior to FAS 123R adoption, we accounted for stock-based payments under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In anticipation of the impact of adopting FAS 123R, we accelerated the vesting of approximately 720,000 shares subject to outstanding stock options in December 2005. The primary purpose of the acceleration of vesting was to minimize the amount of compensation expense recognized in relation to the options in future periods following the adoption by us of FAS 123R. Since we accelerated these shares and adopted FAS 123R using the modified prospective method, we did not record any one-time charges relating to the transition to FAS 123R and the consolidated financial statements for prior periods have not been restated to reflect, and do not include any impact of FAS 123R. As a result of FAS 123R, we expect to award restricted stock units or other compensation in lieu of or in addition to stock options.

As of June 30, 2006, there was approximately, $926,000 of total unrecognized compensation related to unvested stock-based compensation arrangements granted under our equity incentive plans. That cost is expected to be recognized over a weighted-average period of four years.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, including the expected life of the stock-based payment awards and stock price volatility. We use the

Black-Scholes model to value our stock option awards. Management uses an estimate of future volatility for our stock based on our historical volatility and the volatilities of comparable companies. The assumptions used in calculating the fair value of stock-based payment awards represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the actual forfeiture rate is materially different from the estimate, stock-based compensation expense could be significantly different from what has been recorded in the current period. See Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements for a further discussion on stock-based compensation.

Seasonality and Inflation

We anticipate that our business may be affected by the seasonality of certain revenue lines. For example, print and online advertising buys are usually higher approaching year-end and lower at the beginning of a new year than at other points during the year, and sales on our e-commerce websites are affected by the holiday season and by the timing of the release of compilations of new seasons of popular television series and feature films.

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

Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154 (FAS 154), *Accounting Changes and Error Corrections,* which replaces APB Opinion No. 20, *Accounting Changes,* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements,* and changes the requirements for the accounting for and reporting of a change in accounting principle. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of FAS 154 in the three months ended March 31, 2006 did not have a material effect on our results of operations, liquidity or capital resources.

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109* (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. This interpretation is effective on January 1, 2007 for PlanetOut, and we are currently in the process of evaluating the impact of this interpretation on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio in primarily money market funds.

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, trade accounts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments purchased with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents. Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates may have a material impact on the fair value of these securities. A hypothetical 1% increase or decrease in interest rates would not materially increase (decrease) our earnings or loss.

Our operations have been conducted primarily in United States currency and as such have not been subject to material foreign currency exchange rate risk. However, the growth in our international operations is increasing our

exposure to foreign currency fluctuations as well as other risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures and other regulations and restrictions. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. We translate income statement amounts that are denominated in foreign currency into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions results in increased revenue, operating expenses and net income. Conversely, our revenue, operating expenses and net income will decrease when the U.S. dollar strengthens

against foreign currencies. The effect of foreign exchange rate fluctuations for 2005 and the first six months of 2006 were not material.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that the required disclosure information in our Exchange Act reports is recorded, processed, summarized and reported timely as specified by SEC rules and forms, and that such information is communicated in a timely manner to our management, including our Chief Executive Officer and Chief Financial Officer.

We evaluated the effectiveness of the design and operation of disclosure controls and procedures as of June 30, 2006 under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, concluding that disclosure controls and procedures are effective at a reasonable assurance level based upon that evaluation.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended June 30, 2006, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

In April 2002, we were notified that DIALINK, a French company, had filed a lawsuit in France against us and our French subsidiary, alleging that we had improperly used the domain names Gay.net, Gay.com and fr.gay.com in France, as DIALINK alleges that it has exclusive rights to use the word gay as a trademark in France. On June 30, 2005, the French court found that although we had not infringed DIALINK s trademark, we had damaged DIALINK through unfair competition. The Court ordered us to pay damages of 50,000 (US $63,000 at June 30, 2006), half to be paid notwithstanding appeal, the other half to be paid after appeal. The Court also enjoined us from using gay as a domain name for our services in France. In October 2005, we paid half the damage award as required by the court order and temporarily changed the domain name of our French website, from www.fr.gay.com to www.ooups.com, a domain name we have used previously in France. This temporary change may make it more difficult for French users to locate our French website. We have accrued the full damage award and, in January 2006, appealed the French court s decision. DIALINK s reply brief to our appeal is due to be filed by August 30, 2006.

Item 1A. Risk Factors

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

We have experienced significant net losses and we may continue to incur losses in the future. As of June 30, 2006, our accumulated deficit was approximately $35.1 million. Although we had positive net income in the year ended December 31, 2005, we may not be able to regain, sustain or increase profitability in the near future, causing our financial condition to suffer and our stock price to decline.

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

Because a significant portion of our revenue is derived from our subscription services, we must continue to attract and retain subscribers. Many of our new subscribers originate from word-of-mouth referrals from existing subscribers within the LGBT community. If our subscribers do not perceive our service offerings or publications to be of high quality or sufficient breadth, if we introduce new services or publications that are not favorably received or if we fail to introduce compelling new content or features or enhance our existing offerings, we may not be able to attract new subscribers or retain our current subscribers.

Our current online content, shopping and personals platforms may not allow us to maximize potential cross-platform synergies and may not provide the most effective platform from which to launch new or improve current services for our members or market to them. If there is a delay in our plan to improve and consolidate these platforms, and this delay prevents or delays the development or

integration of new features or enhancements to existing features, our subscriber growth could slow or decline. As a result, our revenue would decrease. Our base of likely potential subscribers is also limited to members of the LGBT community, who collectively comprise a small portion of the general adult population.

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

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

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

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

Our operating results have fluctuated in the past and may fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. As a result, we believe that period-over-period comparisons of our operating results are not necessarily meaningful and that you should not rely on the results of one period as an indication of our future or long-term performance. Our operating results in future quarters may be below the expectations of public market analysts and investors, which may result in a decline in our stock price. In particular, with the acquisition of RSVP in March 2006, our operating results could be impacted by the long lead times in the cruise industry, and may fluctuate significantly due to the timing and success of cruises we book.

If we fail to manage our growth, our business will suffer.

We have significantly expanded our operations and anticipate that further expansion will be required to address current and future growth in our customer base and market opportunities. Our expansion has placed, and is expected to continue to place, a significant strain on our technological infrastructure, management, operational and financial resources. If we continue to expand our marketing efforts, we may expend cash and create additional expenses, including additional investment in our technological infrastructure, which might harm our financial condition or results of operations. If despite such additional investments our technological infrastructure is unable to keep pace with our online subscriber and member growth, members using our online services may experience degraded performance and our online subscriber growth could slow or decrease and our revenue may decline.

If we are unable to successfully expand our international operations, our business will suffer.

We offer services and products to the LGBT community outside the United States, and we intend to continue to expand our international presence, which may be difficult or take longer than anticipated especially due to international challenges, such as language barriers, currency exchange issues and the fact that the Internet infrastructure in foreign countries may be less advanced than Internet infrastructure in the United States. In October 2005, we began offering our online premium services free of charge for a limited time in some international markets in an effort to develop critical mass in those markets. Expansion into international markets requires significant resources that we may fail to recover by generating additional revenue.

If we are unable to successfully expand our international operations, if our limited time offer of free online premium services to some international markets fails to develop critical mass in those markets, or if critical mass is

achieved in those markets and members are then unwilling to pay for our online premium services after the limited time offer of free premium services ends, our revenue may decline and our profit margins will be reduced.

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

In November 2005, we significantly expanded our operations by acquiring substantially all of the assets of LPI. In March 2006, we acquired substantially all of the assets of RSVP. In June 2006, we largely completed the integration of the assets we acquired through the LPI and RSVP transactions by executing on a reorganization plan that cut our global workforce by approximately 5% designed to better align our resources with our strategic business objectives. In order to address market opportunities and potential growth in our customer base, we anticipate additional expansion in the future, including possible additional acquisitions of third-party assets, technologies or businesses. Such acquisitions may involve the issuance of shares of stock that dilute the interests of our other stockholders, or require us to expend cash, incur debt or assume contingent liabilities. Our recent acquisitions of LPI and RSVP and other potential future acquisitions may be associated with a number of risks, including:

- the difficulty of integrating the acquired assets and personnel of the acquired businesses into our operations;
- the potential absorption of significant management attention and significant financial resources for the ongoing development of our business;
- the potential impairment of relationships with and difficulty in attracting and retaining employees of the acquired companies or our employees as a result of the integration of acquired businesses;
- the difficulty of integrating the acquired company s accounting, human resources and other administrative systems;
- the potential impairment of relationships with subscribers, customers and partners of the acquired companies or our subscribers, customers and partners as a result of the integration of acquired businesses;
- the difficulty in attracting and retaining qualified management to lead the combined businesses;
- the potential difficulties associated with entering new lines of business with which we have little experience, such as some of the businesses we have acquired from LPI and RSVP;
- the difficulty of complying with additional regulatory requirements that may become applicable to us as the result of an acquisition, such as various regulations that may become applicable to us as a result of our acquisition of LPI, including the acquisition of a related entity that produces some content and other materials intended for mature audiences; and
- the impact of known or unknown liabilities associated with the acquired businesses. For example, in our RSVP business, should some of the third parties with whom we contract in connection with arranging our travel itineraries fail to perform their obligations for any reason, we may be forced to cancel or reschedule planned trips, lose deposits we have made to vendors, refund customer deposits, reimburse other costs to our customers and lose customers for those and other travel itineraries as a result.

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

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

Our success depends on the collective experience of our senior executive team and board of directors and on our ability to recruit, hire, train, retain and manage other highly skilled employees and directors. In June 2006, we experienced some disruptions in our senior executive team, including the resignation, for personal reasons, of our former Chief Executive Officer, Lowell Selvin, and the subsequent appointment of one of our directors, Karen Magee, as our Chief Executive Officer. Additional changes in our senior management took place as part of our June 2006 reorganization. Such disruptions could harm our business and financial results or limit our ability to grow and expand our business. We cannot provide assurance that we will be able to attract and retain a sufficient number of qualified employees or that we will successfully train and manage the employees that we do hire.

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

Online advertising represents a significant portion of our advertising revenue. We compete with traditional media including television, radio and print, in addition to high-traffic websites, such as those operated by Yahoo!, Google, AOL and MSN, for a share of advertisers total online advertising expenditures. We face the risk that advertisers might find the Internet to be less effective than traditional media in promoting their products or services, and as a result they may reduce or eliminate their expenditures on Internet

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

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

If advertisers do not find the LGBT market to be economically profitable, our business will be harmed.

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

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

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

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

Our markets are intensely competitive and subject to rapid change. Across all three of our service lines, we compete with traditional media companies focused on the general population and the LGBT community, including local newspapers, national and regional magazines, satellite radio, cable networks and network, cable and satellite television shows. In our advertising business, we compete with a broad variety of online and print content providers, including large media companies such as Yahoo!, MSN, Time Warner, Viacom and News Corp., as well as a number of smaller companies focused specifically on the LGBT community. In our subscription business, our competitors include these companies as well as other companies that offer more targeted online service offerings, such as Match.com, Yahoo! Personals, News Corp., and a number of other smaller online companies focused specifically on the LGBT community. In our transaction business, we compete with traditional and online retailers. Most of these transaction service competitors target their products and services to the general audience while still serving the LGBT market. Other competitors, however, specialize in the LGBT market, particularly in the gay and lesbian travel space. If we are unable to successfully compete with current and new competitors, we may not be able to achieve or maintain

adequate market share, increase our revenue or achieve and maintain profitability.

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

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

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

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

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

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

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

We are subject to federal, state, local and international laws, including laws affecting companies conducting business on the Internet, including user privacy laws, regulations prohibiting unfair and deceptive trade practices and

laws addressing issues such as freedom of expression, pricing and access charges, quality of products and services, taxation, advertising, intellectual property rights, display and production of material intended for mature audiences and information security. In particular, we are currently required, or may in the future be required, to:

- conduct background checks on our members prior to allowing them to interact with other members on our websites or, alternatively, provide notice on our websites that we have not conducted background checks on our members, which may result in our members canceling their membership or failing to subscribe or renew their subscription, resulting in reduced revenue;

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

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

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

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

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

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

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

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

exceed the DOJ s statutory authority to regulate secondary producers, among other grounds. In July 2006, the Adam Walsh Child Protection and Safety Act of 2006 (the Walsh Act) became law, amending the CPO Act by expanding the definition of the adult materials covered by the CPO Act and by requiring secondary producers to maintain and make available specified records under the CPO Act. The Walsh Act may result in the stay on enforcement of the CPO Act being lifted. If that occurs, and there are no legal challenges to the Walsh Act or these challenges are unsuccessful, we will be subject to significant and burdensome recordkeeping compliance requirements and we will have to evaluate and implement additional registration and recordkeeping processes and procedures, each of which would result in additional expenses to us. If our members and subscribers feel these additional restrictions or registration and recordkeeping processes and procedures are too burdensome, this may result in an adverse impact on our subscriber growth and churn which, in turn, will have an adverse effect on our financial condition and results of operations. Alternatively, if we determine that the recordkeeping and compliance requirements would be too burdensome, we may be forced to limit the type of content that we allow our members to post to their profiles, which will result in a loss of features that we believe our members and subscribers find attractive, and in turn could result in a decline in our subscribers growth.

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

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

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

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

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

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

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

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

A portion of the content of our media properties is adult in nature. Our adult content increased significantly as a result of our November 2005 acquisition of assets from LPI, which included several adult-themed media properties. Advocacy groups may target our business through negative publicity campaigns, lawsuits and boycotts seeking to limit access to our services or otherwise disrupt our operations because we are a provider of adult content. These actions could impair our ability to attract and retain customers, especially in our advertising business, resulting in decreased revenue, and cause additional financial harm by requiring that we incur significant expenditures to defend our business and by diverting management s attention. Further, some investors, investment banking entities, market makers, lenders and others in the investment community may decide not to invest in our securities or provide financing to us because of our adult content, which, in turn, may hurt the value of our stock. Additionally, future laws or regulations, or new interpretations of existing laws and regulations, may restrict our ability to provide adult content, or make it more difficult or costly to do so, such as the Walsh Act, which became law in July 2006, and the regulations adopted by the DOJ in June 2005 purporting to implement the Child Protection and Obscenity Act of 1988.

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

In the United States, federal and state tax authorities are currently exploring the appropriate tax treatment of companies engaged in online commerce, and new state tax regulations may subject us to additional state sales and

income taxes, which could increase our expenses and decrease our profit margins.

In 2003, the European Union implemented new rules regarding the collection and payment of value added tax, or VAT. These rules require VAT to be charged on products and services delivered over electronic networks, including software and computer services, as well as information and cultural, artistic, sporting, scientific, educational, entertainment and similar services. These

services are now being taxed in the country where the purchaser resides rather than where the supplier is located. Historically, suppliers of digital products and services that existed outside the European Union were not required to collect or remit VAT on digital orders made to purchasers in the European Union. With the implementation of these rules, we are required to collect and remit VAT on digital orders received from purchasers in the European Union, effectively reducing our revenue by the VAT amount because we currently do not pass this cost on to our customers.

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

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

As a result of our November 2005 acquisition of assets from LPI, we publish and distribute magazines, such as *The Advocate, Out, The Out Traveler* and *HIVPlus,* among others. The commodity prices for paper products have been increasing over the recent years, and producers of paper products are often faced with production capacity limitations, which could result in delays or interruptions in our supply of paper. In addition, mailing costs have also been increasing, primarily due to higher postage rates. If pricing of paper products and mailing costs continue to increase, if we encounter shortages in our paper supplies, or if our third party vendors fail to meet their obligations for any reason, our revenues and profit margins could be adversely affected.

We may need additional capital and may not be able to raise additional funds on favorable terms or at all, which could increase our costs, limit our ability to grow and dilute the ownership interests of existing stockholders.

We anticipate that we may need to raise additional capital in the future to facilitate long-term expansion, to respond to competitive pressures or to respond to unanticipated financial requirements. In April 2006, we filed a shelf registration statement with the SEC for up to $75.0 million of common stock, preferred stock, debt securities and/or warrants to be sold from time to time at prices and on terms to be determined by market conditions at the time of offering. In addition, under the shelf registration statement some of our stockholders may sell up to 1.7 million shares of our common stock. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms or at all. If we raise additional funds through the issuance of equity, equity-related or debt securities, these securities may have rights, preferences or privileges senior to those of the rights of our common stock, and our stockholders will experience dilution of their ownership interests. A failure to obtain additional financing or an inability to obtain financing on acceptable terms could require us to incur indebtedness that has high rates of interest or substantial restrictive covenants, issue equity securities that will dilute the ownership interests of existing stockholders, or scale back, or fail to address opportunities for expansion or enhancement of, our operations. We cannot assure you that we will not require additional capital in the near future.

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

Our executive offices and our data center are located in the San Francisco Bay area and we have significant operations in Los Angeles. Our business and operations could be disrupted in the event of electrical blackouts, fires, floods, earthquakes, power losses, telecommunications failures, acts of terrorism, break-ins or similar events. Because our California operations are located in earthquake-sensitive areas, we are particularly susceptible to the risk of damage to, or total destruction of, our systems and infrastructure. We are not insured against any losses or expenses that arise from a disruption to our business due to earthquakes. Further, the State of California has experienced deficiencies in its power supply over the last few years, resulting in occasional rolling blackouts. If rolling blackouts or other disruptions in power occur, our business and operations could be disrupted, and we will lose revenue. Revenue from our recently acquired RSVP travel business depends in significant part on ocean-going cruises, and could be adversely affected by piracy or hurricanes, tsunamis and other meteorological events affecting areas to be visited by future cruises. Our travel business could also be materially adversely affected by concerns about

communicable infectious diseases, including future varieties of influenza.

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

We have used stock options and other long-term incentives as a fundamental component of our employee compensation packages. We believe that stock options and other long-term equity incentives directly motivate our employees to maximize long-term stockholder value and, through the use of vesting, encourage employees to remain with our company. Several regulatory agencies and

entities are considering regulatory changes that could make it more difficult or expensive for us to grant stock options to employees. For example, the Financial Accounting Standards Board has adopted changes to the U.S. generally accepted accounting principles that require us to record a charge to earnings for employee stock option grants. In addition, regulations implemented by the Nasdaq Global Market generally requiring stockholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant stock options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive and costly evaluation of their internal controls. As a result, our management is required on an ongoing basis to perform an evaluation of our internal control over financial reporting and have our independent registered public accounting firm attest to such evaluations. Our efforts to comply with Section 404 and related regulations regarding our management s required assessment of internal control over financial reporting and our independent registered public accounting firm s attestation of that assessment has required, and will continue to require, the commitment of significant financial and managerial resources. If we fail to timely complete these evaluations, or if our independent registered public accounting firm cannot timely attest to our evaluations, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls, which could have an adverse effect on our business and our stock price.

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

Since our initial public offering in October 2004, our stock price has been and may continue to be subject to wide fluctuations. From October 14, 2004 through June 30, 2006, the closing sale prices of our common stock on the Nasdaq ranged from $6.25 to $13.60 per share. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in our operating results, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors or analysts deem comparable to us and sales of stock by our existing stockholders.

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

Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

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

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

As a Delaware corporation, we are also subject to Delaware law anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the

holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On October 13, 2004, a registration statement on Form S-1 (No. 333-114988) was declared effective by the Securities and

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Exchange Commission, pursuant to which 5,347,500 shares of common stock were offered and sold by us at a price of $9.00 per share, generating total proceeds, net of underwriting discounts and commissions and issuance costs of approximately $42.9 million. In connection with the offering, we incurred approximately $2.9 million in underwriting discounts and commissions and approximately $1.9 million in other related expenses. The managing underwriters were SG Cowen & Co., LLC, RBC Capital Markets Corporation and WR Hambrecht + Co, LLC. We have used the net proceeds from our initial public offering to invest in short-term, investment grade interest-bearing securities, to pay off the principal and interest under our senior subordinated promissory note, for acquisitions and for working capital needs. We may use a portion of the net proceeds to acquire or invest in products and technologies that are complementary to our own, although no portion of the net proceeds has been allocated for any specific acquisition. None of the net proceeds of the initial public offering were paid directly or indirectly to any director, officer, general partner of PlanetOut or their associates, persons owning 10% or more of any class of our or our affiliates equity securities.

From the time of receipt through June 30, 2006, the proceeds of our public offering were applied toward repayment of the principal and interest of the senior subordinated note in the amount of $5.0 million, $25.5 million for the acquisition of the assets of LPI and $5.4 million for the acquisition of the assets of RSVP. The remaining proceeds of $7.0 million are being used as working capital and are included within cash and cash equivalents and restricted cash. We expect that the use of the remaining proceeds will conform to the intended use of proceeds as described in our initial public offering prospectus filed on October 14, 2004.

Repurchases of Equity Securities.

Period	**(a) Total Number of Shares Purchased (1)**	**(b) Average Price Paid per Share**	**(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs**
April 1, 2006 April 30, 2006		$		
May 1, 2006 May 30, 2006				
June 1, 2006 June 30, 2006				
Total		$		

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

Item 3. Defaults Upon Senior Securities.

Not Applicable.

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

Our 2006 annual meeting of stockholders was held on June 14, 2006, to elect two directors to the board of directors and to ratify the appointment of Stonefield Josephson, Inc. as our independent auditors for the fiscal year ending December 31, 2006.

In the election of directors, the two director nominees were elected with the following votes:

	Number of Votes	
Nominee	**For**	**Withheld**
H. William Jesse, Jr.	13,390,253	27,875
Karen Magee	13,400,627	17,501

Directors whose terms of office continued after the meeting are Lowell R. Selvin, Jerry Colonna, Robert W. King and Allen Morgan.

The stockholders voted in favor of the ratification of the appointment of Stonefield Josephson, Inc. as our independent public auditors for the fiscal year ending December 31, 2006, as follows:

	Number of Votes			
	For	**Against**	**Abstain**	**Broker Non-Votes**
Ratification of appointment of auditors	13,373,691	14,323	30,114	11,654,825

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Item 5. Other Information.

Not Applicable.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description of Documents
3.1	Amended and Restated Certificate of Incorporation, as currently in effect (filed as Exhibit 3.3 to our Registration Statement on Form S-1, File No. 333-114988, initially filed on April 29, 2004, declared effective on October 13, 2004, and incorporated herein by reference).
3.2	Amended and Restated Bylaws, as currently in effect (filed as Exhibit 3.4 to our Registration Statement on Form S-1, File No. 333-114988, initially filed on April 29, 2004, declared effective on October 13, 2004, and incorporated herein by reference).
4.1	Specimen of Common Stock Certificate (filed as Exhibit 4.1 to our Registration Statement on Form S-1, File No. 333-114988, initially filed on April 29, 2004, declared effective on October 13, 2004, and incorporated herein by reference).
4.2	Form of Senior Debt Indenture (filed as Exhibit 4.5 to our Registration Statement on Form S-3, File No. 333-133536, filed on April 25, 2006 and incorporated herein by reference).
4.3	Form of Subordinated Debt Indenture (filed as Exhibit 4.6 to our Registration Statement on Form S-3, File No. 333-133536, filed on April 25, 2006 and incorporated herein by reference).
10.26	Employment Agreement dated as of June 20, 2006 by and between Karen Magee and PlanetOut Inc. (filed as Exhibit 99.1 to our Current Report on Form 8-K, File No. 000-50879, filed on June 23, 2006 and incorporated herein by reference).
12.1	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certificate of Chief Executive Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of Chief Financial Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Chief Executive Officer pursuant to Section 18 U.S.C section 1350.
32.2	Certificate of Chief Financial Officer pursuant to Section 18 U.S.C. section 1350.

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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.

PLANETOUT INC.

Date: August 9, 2006

By: /s/ DANIEL J. MILLER

Daniel J. Miller
Senior Vice President, Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

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