

EDIETS COM INC  
Form 10-K  
March 22, 2005  
Table of Contents

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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

For fiscal year ended December 31, 2004

Commission File Number: 0 30559

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**eDiets.com, Inc.**

(Name of registrant in its charter)

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

**56-0952883**  
(I.R.S. Employer  
Identification No.)

**3801 W. Hillsboro Boulevard**  
**Deerfield Beach, Florida 33442**  
(Address of principal executive offices)

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(954) 360-9022

(Registrant's telephone number, including area code)

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

**Securities registered pursuant to Section 12(g) of the Act: Common Stock, Par Value \$0.001 Per Share**

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of shares of the Common Stock held by non-affiliates at the end of the most recently completed second fiscal quarter, based upon the average of the bid and asked prices for such stock on that date, was approximately \$38,889,000. As of March 14, 2005 there were 21,373,264 shares of the registrant's Common Stock outstanding.

Documents incorporated by reference: The information required pursuant to Part III of this report is incorporated by reference from the Company's definitive proxy statement, relating to the 2005 Annual Meeting of Stockholders.

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**Table of Contents**

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

The information contained in this Annual Report on Form 10-K, other than historical information, may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Words such as may, will, expect, intend, anticipate, believe, estimate, plan and similar expressions in this report identify forward-looking statements. The forward-looking statements are based on current views with respect to future events and financial performance. Actual results may differ materially from those projected in the forward-looking statements. The forward-looking statements are subject to risks, uncertainties and assumptions, including, among other things those associated with:

our ability to meet our financial obligations;

the relative success of marketing and advertising;

the continued attractiveness of our diet and fitness programs;

competition, including price competition and competition with self-help weight loss and medical programs;

our ability to obtain and continue certain relationships with the providers of popular nutrition and fitness approaches;

adverse results in litigation and regulatory matters, more aggressive enforcement of existing legislation or regulations, a change in the interpretation of existing legislation or regulations, or promulgation of new or enhanced legislation or regulations;

general economic and business conditions; and

terrorist activities and the prospect of or the actuality of war.

The factors listed in the section entitled "Certain Factors Which May Affect Future Results" in the section "Management's Discussion and Analysis of Financial Condition and Results of Operations", as well as any other cautionary language in this report, provide examples of risks, uncertainties and events which may cause our actual results to differ materially from the expectations we described in our forward-looking statements. We do not undertake any obligation to publicly release the result of any revisions to these forward-looking statements, which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

**PART I**

**ITEM 1. BUSINESS**

**GENERAL**

Products and Services

eDiets.com, Inc. ( eDiets , the Company or we ) is executing a strategy to be a leading online provider of services, information and products related to nutrition, fitness and motivation. In 2004, we derived approximately 86% of our total revenues of \$45,407,000 from the sale of approximately 465,000 personalized subscription-based online nutrition plans related to weight management and dietary regimens. As of December 31, 2004, we had approximately 192,000 paying subscribers.

Our subscription products include:

**Customized diet plans** and the related shopping lists

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**Table of Contents**

**Customized fitness plans** including cardiovascular activities, strength training and stretching

**Support** including interactive online information, communities and education as well as 24/7/365 telephone support. eDiets offers approximately 100 message boards on various topics of interest to our members, OnlineAnytime<sup>SM</sup> Meetings, multimedia educational segments presented by licensed mental health counselors, registered dietitians, certified fitness trainers and the resources of approximately 60 customer service representatives, nutritionists and fitness personnel. In 2004 we began to offer our support offerings on a standalone basis under the name eDiets | Solutions<sup>SM</sup>.

Our subscription programs are usually billed in advance in varying increments of weeks or months. Substantially all of our members purchase programs via credit cards, with renewals billed automatically, until cancellation. One week of a basic eDiets membership costs less than one-third the cost of a weekly visit to Weight Watchers®, the leading classroom-based diet program or to weightwatchers.com, its online affiliate.

Since 2003, we have undertaken a unique strategy to obtain exclusive licenses for the intellectual property associated with a variety of third party nutrition and fitness approaches and to offer personalized versions of these approaches in addition to our own internally-developed plans. To date, eDiets has obtained licenses from Atkins Nutritionals, Inc., dermatologist Dr. Nicholas Perricone, author of *The Perricone Prescription*, Slim-Fast®, Inc., Bob Greene, fitness trainer for Oprah Winfrey, The Bristol-Myers Squibb Company, producer of the ChoiceDM line of products for Type 2 diabetics, Bill Phillips, author of *Fit for Life*, Dr. Melinda Sothorn, author of *Trim Kids* and Dr. Peter D. Adamo, author of the *Eat Right 4 Your Type*.

Our Web site includes free, regularly updated content developed primarily by our in-house editorial staff. In 2004 we adopted a new Web format and began to group our content into channels including Diet & Nutrition, Fitness, Sex & Relationships, Health, Food & Recipes, Motivation, Style & Beauty, Low Carb Solutions, Healthy Kids and Success Stories. During 2004 we also expanded our portfolio of free email newsletters. Our newsletter titles, which are distributed on an individual opt-in basis to a subscriber base of approximately 13 million, include *eDiets EXTRA!*, *Beauty*, *Psychology*, *Worst Foods*, *Sex Factor*, *Low Carb*, *Diabetes*, *Healthy Hearts* and *Healthy Kids*. We derive revenues from the sale of advertising as well as sales of products and services from our site traffic and newsletter readership. In 2004, approximately 9% of our revenues were from the sale of advertising, both on our Web sites and in our weekly e-newsletters, while e-commerce accounted for approximately 2% of our revenues.

Outside of the U.S., through our wholly-owned subsidiary, eDiets Europe, we operate web sites and offer online nutrition services in Germany at www.eDiets.de and in Spain at www.eDiets.es. We also have a licensing relationship with Tesco plc, the largest retailer in the United Kingdom. In July 2004 we granted to Tesco.com the exclusive rights to use our technology in the United Kingdom and Ireland and we now receive and recognize royalty payments related to that license. Revenues from our international activities totaled approximately \$0.5 million in 2004, which are consolidated in the accompanying Consolidated Financial Statements. See Item 7 for more details.

In aggregate, we employ 148 employees, 140 of whom are full-time, who operate out of two leased facilities totaling 10,400 square feet in Deerfield Beach, Florida as well as a 500 square foot facility in Dublin, Ireland.

Information contained on our web site, or on any other web site mentioned in this Annual Report, is not incorporated by reference in this Annual Report and does not constitute a part of this Annual Report.

*Developments in the U.S. Weight Management Market*

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Our long-term product development and marketing plans are based on our thesis that over time individuals are becoming more aware of the negative health and financial consequences of being overweight and, therefore, more will focus not only on weight loss but also on healthy weight maintenance. A 2001 study by Sturm and Wells chronicled in the publication *Public Health* concluded that obesity was linked to higher rates of chronic illness than

## Table of Contents

living in poverty, and much higher [rates] than smoking or drinking. In addition, during 2003 the American Cancer Society reported that as many as 14% of cancer deaths in men and 20% of cancer deaths in women could be related to being overweight.

Turning from the health to the financial costs of obesity, during 2003 a study based on data from the approximately 180,000 employees in General Motors' healthcare plan showed that an overweight adult has annual healthcare costs that are 7.3% higher than a person in a healthy weight range, while obese individuals have annual healthcare costs that are 69% higher than a person of a healthy weight. We believe that, with healthcare cost inflation running in the double digits in the United States since 2000, the implementation of effective weight management tools will attract more attention from insurers, employers, consumers and the government.

In 2004 the U.S. Department of Health and Human Services removed language from its National Coverage Determinations (NCD) Manual that prevented obesity from being considered an illness. As a result, parties engaged in the treatment of obesity may now submit scientific and medical evidence to NCD for a determination as to whether the National Center for Medicare & Medicaid Services deems their approaches to be effective in improving Medicaid recipients' health outcomes. Such an efficacy review is typically a prerequisite to having an approach become reimbursable under Medicare. In addition, the U.S. Food and Drug Administration, Department of Health and Human Services and Federal Trade Commission are contemplating new labeling requirements for packaged food and restaurant food, new educational and motivational programs related to healthy eating and exercise and increased regulation of advertising claims for food and nutraceuticals. We believe that as consumers are inundated with more and more information and options related to weight loss, nutrition and exercise, and as insurers become more willing to promote, subsidize and reimburse consumers who participate in weight management programs, demand will continue to increase for resources such as our Web sites, where consumers can choose and personalize healthy living plans, then adjust those plans as their needs evolve over a lifetime.

## Market Potential

Approximately 60% of the U.S. adult population, or 120 million adults, are overweight and, of those, the Calorie Control Council estimates only about 50 million are dieting in a given year. About 15% of these dieters are using a commercial weight loss center, generating revenues of approximately \$1.5 billion annually. We target dieters who are online, which represents about two-thirds of the total universe at current Internet penetration rates, or 34 million adults, about 5 million of whom are spending approximately \$1 billion at weight loss centers. With sales of approximately 465,000 diet subscriptions and \$45.4 million in revenues in 2004, we believe that we have captured only between 1 percent and 4 percent of our annual addressable market.

At the same time, the online dieting segment of the market is growing rapidly. We estimate that the online diet industry in the U.S. generated approximately \$185 million in revenues in 2004, compared to approximately \$75 million in 2002, an annualized compound growth rate of 57%.

## Marketing

We sold approximately 465,000 paying memberships in 2004. Our database of individuals currently opting to receive our emails totals approximately 13 million. We attract our paying and newsletter subscribers through banner advertisements running on third party and affiliate Web sites, along with users querying diet terms on popular search engines. We estimate that the MSN® network and AOL® each were the source of more than 10% of our total new members. In addition, during 2004 we launched a television advertising campaign. Over the course of the year, we estimate that television was directly responsible for approximately 10% of new members.

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With advertising spending comprising approximately 59% of our total operating expenses in 2004, our ability to turn advertising dollars into paying customers is critical. To that end, we utilize patented real-time consumer response measurement technology for which we hold an exclusive royalty-free perpetual license from our founder and Chief Executive Officer David Humble. In addition, in early 2004 we made significant incremental investments both in third-party software and in personnel to further enhance our management of our banner advertising and our email marketing.



**Table of Contents**

**Competition**

Our most closely related competitors are other online nutrition and diet-oriented Web sites like [www.weightwatchers.com](http://www.weightwatchers.com). The next most closely related group of competitors are commercial weight loss centers, an industry that has shown marked decline in the last decade. According to Marketdata Enterprises, the number of commercial weight loss centers in the U.S. declined approximately 50% between 1991 and 2001, from over 8,600 to approximately 4,600. In the U.S., the leading offline commercial weight loss companies using a center-based approach include Weight Watchers International, Jenny Craig and LA Weight Loss. We compete against this segment on the basis of lower price, superior value, convenience, availability, the ability to personalize a meal plan on an ongoing basis, our extensive support capabilities and the breadth of our meal plan options.

At the same time, with our adoption in 2003 of a multi-brand strategy to offer personalized online versions of third party branded diet and nutrition plans, commercial weight loss companies became not only competitors, but also potential licensors. We are currently pursuing additional licensing opportunities with companies in this segment. As an example, in early 2004 we licensed the rights to the Slim-Fast meal plans.

**Dependence on Third Parties**

We derive significant portions of our business from relationships with both third party Web sites and third party licensors. Certain advertising partners from whom we derive meaningful volumes of new customers are noted above. In addition, beginning in April 2003 we began to offer online personalized meal plans based upon intellectual property licensed from third parties.

In addition, we depend on certain third party technology vendors for the day-to-day smooth operation and availability of our Web site and services. We have designed our infrastructure to provide reliability and scalability as it supports our operations. Our data centers are located within two secure third-party web hosting facilities in Sterling, Virginia and Miami, Florida. The facilities provide us with:

- ready access to increased network bandwidth;
- improved redundancy, security, and disaster recovery; and
- 24-hour onsite management and support.

Although the facilities provide us with increased security and reliability, there can be no assurance that we will not experience an interruption in service. During 2004, our site was operating 99.3% of the time. To the extent that service is interrupted or delayed, we could experience a decrease in traffic, loss of customers and harm to our reputation. However, we believe that we could secure alternate technology infrastructure vendors rapidly.

**INTELLECTUAL PROPERTY, PROPRIETARY RIGHTS AND DOMAIN NAMES**

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Our success depends on the protection of our original interactive proprietary software and systems and the goodwill associated with our trademarks and other proprietary intellectual property rights. Our interactive personalized diet programs are based on proprietary software that we have developed.

David R. Humble, our founder and Chief Executive Officer, was awarded a U.S. patent in 2002 covering the means of using the Internet to provide an interactive link in a store for the purpose of providing retailers and manufacturers with information to measure the response of the consumers to sales and marketing information. He has granted us a royalty-free exclusive perpetual license to use the aspects of the invention under the patent that relate to our Internet marketing program. We have incorporated limited aspects of this software into our software to measure consumer response in real time to marketing, pricing and other elements of our program. For example, we can measure consumer response to changes in our page format or the attractiveness of various payment options. We can receive real time responses to these modifications and options. We believe that this consumer-response technology will allow us to effectively deploy our online advertising expenditures in 2005 and is an advantage we have over our competitors.

We attempt to protect our intellectual property and proprietary rights through a combination of trademark, copyright and patent law, trade secret protection and confidentiality agreements with our employees and marketing and advertising partners. We pursue the registration of our domain names, trademarks and service marks and patents in

**Table of Contents**

the United States and abroad. A substantial amount of uncertainty exists concerning the application of the intellectual property laws to the Internet and there can be no assurance that existing laws provide adequate protection of our proprietary intellectual property or our domain names. The steps we take to protect our proprietary rights may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks, service marks and similar proprietary rights.

**GOVERNMENT REGULATION**

There is an increasing number of laws and regulations being promulgated by the United States governments, governments of individual states and governments overseas that pertain to the Internet and doing business online. In addition, a number of legislative and regulatory proposals are under consideration by federal, state, local and foreign governments and agencies. Laws or regulations have been or may be adopted with respect to the Internet relating to:

liability for information retrieved from or transmitted over the Internet;

online content regulation;

commercial e-mail;

visitor privacy; and

taxation and quality of products and services.

Moreover, the applicability to the Internet of existing laws governing issues such as:

intellectual property ownership and infringement;

consumer protection;

obscenity;

defamation;

employment and labor;

the protection of minors;

health information; and

personal privacy and the use of personally identifiable information.

This area is uncertain and developing. Any new legislation or regulation or the application or interpretation of existing laws may have an adverse effect on our business. Even if our activities are not restricted by any new legislation, the cost of compliance may become burdensome, especially as different jurisdictions adopt different approaches to regulation.

#### **LIABILITY FOR INFORMATION RETRIEVED FROM OUR WEBSITE AND FROM THE INTERNET**

Content may be accessed on our Web site and this content may be downloaded by visitors and subsequently transmitted to others over the Internet. This could result in claims made against us based on a variety of theories, including, but not limited to, tort, contract and intellectual property violations. We could also be exposed to liability with respect to content that may be posted by visitors to our chat rooms or bulletin boards. It is also possible that if any information contains errors or false or misleading information or statements, third parties could make claims against us for losses incurred in reliance upon such information. In addition, we may be subject to claims alleging that, by directly or indirectly providing links to other Web sites, we are liable in tort, contract or intellectual property, for the wrongful actions of third party Web site operators. The Communications Decency Act of 1996, as amended, provides that, under certain circumstances, a provider of Internet services shall not be treated as a publisher or speaker of any information provided by a third-party content provider. This safe harbor has been interpreted to exempt certain activities of providers of Internet services. Our activities may prevent us from being able to take advantage of this safe harbor provision. Any claims brought against us in this respect may have a material and adverse effect on our business.

## **Table of Contents**

### **PRIVACY CONCERNS**

The Federal Trade Commission (FTC) has adopted regulations and guidelines regarding the collection and use of personally identifiable consumer information obtained from individuals when accessing Web sites, with particular emphasis on access by minors. Such regulations include requirements that companies establish certain procedures to, among other things:

give adequate notice to consumers regarding the type of information collected and disclosure practices;

provide consumers with the ability to have personally identifiable information deleted from a company's database;

provide consumers with access to their personal information and with the ability to rectify inaccurate information;

notify consumers of changes to policy and procedure for the use of personally identifiable information;

clearly identify affiliations with third parties that may collect information or sponsor activities on a company's Web site; and

obtain express parental consent prior to collecting and using personal identifying information obtained from children under 13 years of age.

These regulations also include enforcement and redress provisions. We have implemented and intend to continue to implement programs designed to enhance the protection of the privacy of our visitors and comply with these regulations. However, the FTC's regulatory and enforcement efforts may adversely affect our ability to collect personal information from visitors and customers and therefore limit our marketing efforts.

### **TRADE PRACTICES REGULATIONS**

The FTC and certain states' regulatory authorities regulate advertising and consumer matters such as unfair and deceptive trade practices. The FTC has recently renewed its focus on claims made in weight-loss advertisements, announcing for example in December 2003 an education campaign to assist media in voluntarily screening out weight-loss product advertisements containing claims that are too good to be true. In addition, the state of Florida, where our corporate offices are located, regulates certain marketing and disclosure requirements for weight loss providers. The nature of our interactive Internet activities may subject us to similar legislation in a number of other states. Although we intend to conduct our operations in compliance with applicable regulatory requirements and continually review our operations to verify compliance, we cannot ensure that aspects of our operations will not be reviewed and challenged by the regulatory authorities and that if challenged that we would prevail. Furthermore, we cannot ensure that new laws or regulations governing weight loss and nutrition services providers will not be enacted, or existing laws or regulations interpreted or implied in the future in such way as to cause harm to our business.

In addition, while we receive most of our revenue from membership subscriptions, we also rely at least in part on advertising revenue. Many of these advertisements are weight-loss related. Any regulations or enforcement actions that adversely affect the companies which advertise on our Web site may indirectly have an adverse effect on us through either lower advertising budgets at those companies, redirected marketing

campaigns or restrictions on the type of advertisements that these companies run.

#### **COMMERCIAL E-MAIL REGULATION**

As an Internet-based company, we rely largely on online advertising and e-mail in our marketing efforts. The use of e-mail advertising may become less effective in the future for a number of reasons. Some of these reasons are

## **Table of Contents**

regulatory, as legislators attempt to address problems related to perceived deceptive practices in unsolicited bulk e-mails. For example, the federal CAN-SPAM Act of 2003, which became effective January 1, 2004, places requirements on certain commercial e-mail activity relating to, among other things, making conspicuous and effective opt-out procedures available to the recipient and the identification and location of the sender. We have implemented procedures to ensure compliance with the federal CAN-SPAM Act of 2003, but future legislation or regulatory developments under existing laws may have a negative impact on our ability to advertise by e-mail. E-mail advertising also may become less effective in the future for non-regulatory reasons, including the sheer volume of unsolicited e-mail being received, increased use of white lists through which only pre-approved sender addresses are not filtered, and other e-mail filtering systems which may become more robust in response to recent viruses and worms circulating on the Internet.

Furthermore, we cannot provide any assurance that future regulation of commercial e-mail will not also impose significant costs or restrictions on even subscriber-based or opt-in e-mail services such as our newsletter service. As part of the public debate on commercial e-mail regulations, for example, some have advocated an electronic stamp program applicable to commercial e-mail generally, and it is unclear what exceptions, if any, there would be under such a program for a periodic newsletter service such as ours if such a program were passed as legislation.

## **REGULATION BY OTHER JURISDICTIONS**

Due to the global nature of the Internet, it is possible that, although transmissions by us over the Internet originate primarily in the United States, the governments of other foreign countries might attempt to regulate our transmissions or prosecute us for violations of their laws. These laws may be modified, or new laws enacted, in the future. We may unintentionally violate these laws to the extent that our transmissions are sent to or made available in these jurisdictions. Like domestic regulations that may apply to our activities, even if compliance is possible the cost of compliance may be burdensome. Any of these developments could cause our business to suffer. In addition, as our service is available over the Internet in multiple states and foreign countries, these jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. We have not qualified to do business as a foreign corporation in any jurisdiction, except Florida. This failure by us to qualify as a foreign corporation in a jurisdiction where we are required to do so could subject us to taxes and penalties and could result in our inability to enforce contracts in such jurisdictions.

## **Company Information**

General information about us can be found at <http://www.eDiets.com/company/company.cfm>. We make available our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act) as soon as reasonably practicable after we electronically file such materials with the Securities and Exchange Commission, free of charge on our web site.

## **General Development of the Business**

The predecessor to eDiets was incorporated in the State of Delaware in March 1996 under the name Self-help Technologies, Inc. The Company's mission was, and remains, to provide solutions that help individuals to realize their full potential. Initially, the product developed and promoted was personalized diet programs for direct to consumer sales at in-store at locations such as grocery stores. However, we quickly shifted our promotional strategy to online direct to consumer sales as consumer acceptance and usage of the Internet began to accelerate.

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Much of 1996 and 1997 was spent in developing a unique software platform that facilitates the production of individualized meal plans and shopping lists using a specific mathematical algorithm, which takes into account such criteria as the user's physical condition, proclivity to exercise, food preferences, cooking preferences, desire to use pre-packaged meals or dine out, among others. We believe that it would take many months or even years of development to replicate this software platform.

We sold our first online diet program in 1997 and continued to market memberships through modest online advertising arrangements with several leading Internet portals throughout 1998 and 1999. These advertising arrangements were enhanced in February 1999 when our founder and Chief Executive Officer David Humble



**Table of Contents**

completed the development of software that measures consumer response to marketing, pricing and other elements of a direct marketing campaign. Mr. Humble has granted the Company a perpetual royalty-free license for this technology for use in the scope of its current business.

In November 1999 eDiets merged into a newly-created, wholly-owned subsidiary of Olas, Inc., a publicly-traded company of which substantially all of the operating assets had been sold in 1995. Olas, Inc. then changed its name to eDiets.com, Inc. Following the merger, in November and December 1999 eDiets completed a private placement of common stock and warrants that generated approximately \$6.3 million in net proceeds to the Company. Beginning in early 2000, we primarily used the proceeds from this financing to fund online advertising expenditures that significantly increased in the Company's base of paying subscribers.

In November 2000, we entered into a joint venture with Unislim Ireland, Limited, the leading weight loss center business in Ireland, to market eDiets diet programs in the United Kingdom and parts of continental Europe as well as Australia and New Zealand. The joint venture was known as eDiets Europe, Ltd. ( eDiets Europe ). eDiets received a 60% interest in eDiets Europe primarily in return for licensing international technology rights to it; Unislim received the remaining interest for a cash investment of \$250,000. eDiets Europe launched its first Web site, www.eDietsuk.co.uk, in April 2001. In July 2004, eDiets BVI, Inc., a wholly-owned subsidiary of eDiets.com, Inc., acquired the 40% of eDiets Europe not already owned for approximately \$1,529,000 and 255,605 shares of common stock of eDiets.com, Inc. valued at approximately \$726,000. As a result, eDiets Europe became a wholly-owned subsidiary of the Company.

**Revenue and Related Expense Recognition:** Membership fees are billed in advance and in almost all cases are charged to the subscriber's credit card, resulting in immediate subscription cash flow to the Company. However, under United States Generally Accepted Accounting Principles ( GAAP ), various portions of these fees are recognized ratably over the period being charged. Subscription cycles average 5 - 6 months, depending on the price terms offered. The difference between cash fees received and the portion previously recognized is reflected in deferred revenues in our balance sheet; the majority of these revenues are expected to be recognized within the next fiscal quarter. Our deferred revenue balance totaled \$5.8 million at December 31, 2004, compared to \$3.9 million at December 31, 2003. Deferred revenue of \$5.8 million includes \$2.4 million of non-refundable fees received in July 2004 under a 15-year exclusive technology licensing agreement related to the Company's operations in the United Kingdom and Ireland and the remaining \$3.4 of deferred revenue related to subscription fees prepaid by members.

There are timing differences between when we receive subscription revenues and when we pay the associated online advertising expense, and these differences result in both negative cash flow and negative profitability under GAAP during the early part of a subscription cycle (a cycle is defined as the initial membership period plus any subsequent successive renewals). As a result, we may report losses under GAAP and negative cash flow from operations during periods when we are aggressively building or replacing our membership base. The difference between cash flows and GAAP accounting associated with customer acquisition is illustrated below.

**Cash Flow**

Revenue for initial subscription period received and advertising payment paid at time of sale of the subscription; additional subscription fees received with each renewal period

**GAAP Accounting**

Revenue recognized ratably; advertising cost expensed at time of sale of the subscription early part of subscription cycle shows GAAP loss, later part of cycle shows GAAP profit cumulative profit or loss is the same as cash flow

**Seasonality:** We typically experience our weakest click-through and conversion rates during our fiscal fourth quarter due to the November-December holiday season, and we moderate our advertising expenditures accordingly.

**Table of Contents****ITEM 2. PROPERTIES**

We currently lease a total of approximately 10,400 square feet of office space in Deerfield Beach, Florida as well as a 500 square foot facility in Dublin, Ireland. We have approximately 6,500 square feet under a lease due to expire in September 2006, approximately 3,900 square feet under a lease due to expire in May 2005 and 500 square feet renewable monthly. The aggregate current monthly rental, including lessor leasehold improvements repayment obligations and pro-rated share of common area facilities expenses, is approximately \$21,000.

**ITEM 3. LEGAL PROCEEDINGS**

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

In November 2003, Weight Watchers International filed a trade complaint against us before the National Advertising Division of the Better Business Bureau ( NAD ) for false and misleading advertising. The trade complaint asserted that several advertisements and claims made on the Company's web site and in banner advertisements were false, misleading or unsubstantiated. In May 2004, the NAD upheld several of our advertisements and also concluded that several others should be modified. We complied with these recommendations, because although voluntary, could result in a referral by the NAD to the Federal Trade Commission to the extent that we do not comply with its recommendations. In June 2004, Weight Watchers appealed the decision of the NAD to the extent that it upheld one of our advertising messages ( Lose 10 pounds in 2 weeks ) and requested that the National Advertising Review Board ( NARB ) appoint a panel to review that aspect of the decision. Weight Watcher's request was subsequently granted by the NARB. In November of 2004 the NARB affirmed the NAD decision and rejected Weight Watchers' challenge to this advertising claim.

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

At our annual meeting of stockholders held November 4, 2004 the Company's stockholders voted on the following proposals:

## 1. Proposal to elect directors:

	<b>For</b>	<b>Withheld</b>
David R. Humble	17,858,491	215,513
Lee S. Isgur	16,253,429	1,820,575
Ciaran G. McCourt	17,896,791	177,213
Pedro N. Ortega-Dardet	17,897,559	176,445
Andrea M. Weiss	17,897,659	176,345
Robert L. Doretti	17,897,659	176,345
Ronald Luks	17,897,659	176,345

## 2. Proposal to ratify the election of Ernst &amp; Young LLP as the Company's independent auditors for fiscal 2004:

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For	17,891,497
Against	168,240
Abstain	14,267
Broker Non-Votes	5,902,391

**Table of Contents**

3. Proposal to approve the 2004 Equity Incentive Plan (the Plan ) and the issuance of 1.5 million shares of the Company's common stock pursuant the Plan:

For	11,149,634
Against	1,006,513
Abstain	15,466

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

Our common stock commenced trading on the Nasdaq SmallCap Market under the symbol DIET on February 17, 2004. Our common stock previously traded over-the-counter and was quoted on the OTC Electronic Bulletin Board under the symbol EDET. The following table sets forth the high and the low bid quotations for the common stock as quoted on the Nasdaq SmallCap Market and as reported on the OTC Electronic Bulletin Board for the periods indicated. Such information reflects inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	<u>LOW BID</u>	<u>HIGH BID</u>
<b>YEAR ENDED DECEMBER 31, 2004:</b>		
Fourth quarter	\$ 3.11	\$ 4.93
Third quarter	\$ 2.19	\$ 3.88
Second quarter	\$ 2.50	\$ 7.12
First quarter	\$ 5.70	\$ 9.55
<b>YEAR ENDED DECEMBER 31, 2003:</b>		
Fourth quarter	\$ 3.05	\$ 6.18
Third quarter	\$ 1.95	\$ 5.45
Second quarter	\$ 0.90	\$ 2.55
First quarter	\$ 1.13	\$ 1.70

As of March 14, 2005, there were approximately 141 holders of record of our common stock. This number does not include the number of persons whose stock is held in nominee or street name accounts through brokers.

We have never declared or paid cash dividends. We currently intend to retain any earnings for use in the business and do not anticipate paying any cash dividends on our capital stock in the foreseeable future.

**ITEM 6. SELECTED FINANCIAL DATA**

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The following table summarizes certain selected consolidated financial data of the company as of, and for each of the years in the five-year period ended December 31, 2004. The selected consolidated financial data has been derived from our audited Consolidated Financial Statements. The selected consolidated financial data should be read in conjunction with our Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and Notes included in this Annual Report.

**Table of Contents**

	YEAR ENDED DECEMBER 31,				
	2004	2003	2002	2001	2000
	(in thousands, except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Revenue	\$ 45,407	\$ 38,332	\$ 29,628	\$ 24,371	\$ 11,434
<b>Costs and Expenses:</b>					
Cost of revenue	6,387	4,701	3,081	2,142	846
Product development	2,507	1,581	1,381	752	242
Sales and marketing	39,936	28,199	17,640	16,849	12,869
General and administrative	5,695	4,476	4,660	3,185	2,774
Depreciation and amortization	879	1,171	1,321	663	314
Impairment of intangible assets	54	183			
<b>Total costs and expenses</b>	<b>55,458</b>	<b>40,311</b>	<b>28,083</b>	<b>23,591</b>	<b>17,045</b>
(Loss) income from operations	(10,051)	(1,979)	1,545	780	(5,611)
Other income (expense), net	115	13	(172)	(11)	161
(Loss) income before income tax benefit	(9,936)	(1,966)	1,373	769	(5,450)
Income tax benefit	33	258	251	25	
<b>Net (loss) income</b>	<b>\$ (9,903)</b>	<b>\$ (1,708)</b>	<b>\$ 1,624</b>	<b>\$ 794</b>	<b>\$ (5,450)</b>
<b>Per Share Data:</b>					
(Loss) earnings per common share:					
Basic	\$ (0.49)	\$ (0.10)	\$ 0.10	\$ 0.06	\$ (0.41)
Diluted	\$ (0.49)	\$ (0.10)	\$ 0.09	\$ 0.05	\$ (0.41)
<b>Weighted average common and common equivalent shares outstanding:</b>					
Basic	20,091	16,675	15,730	13,961	13,215
Diluted	20,091	16,675	17,132	15,110	13,215
	YEAR ENDED DECEMBER 31,				
	2004	2003	2002	2001	2000
	(in thousands)				
<b>Consolidated Statement of Cash Flows Data:</b>					
Net cash provided by (used in):					
Operating activities	\$ (7,632)	\$ 2,917	\$ 2,670	\$ 2,111	\$ (4,482)
Investing activities	2,064	(677)	(647)	(1,227)	(510)
Financing activities	8,348	1,679	(1,721)	(129)	(204)
	DECEMBER 31,				
	2004	2003	2002	2001	2000

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(in thousands)					
Consolidated Balance Sheet Data:					
Total assets	\$ 20,140	\$ 14,143	\$ 12,574	\$ 11,214	\$ 3,717
Long-term debt (excluding capital lease obligations)		2	504	2,025	
Shareholders' equity	5,296	5,950	5,286	3,613	306

**Table of Contents****ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****RESULTS OF OPERATIONS**

The following table shows our results of operations expressed as a percentage of total revenues:

	<b>YEAR ENDED DECEMBER 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Revenue	100%	100%	100%
Cost of revenue	14	12	10
Product development	6	4	5
Sales and marketing	88	73	59
General and administrative	12	12	16
Depreciation and amortization	2	3	4
Impairment of intangible assets	*	*	
Other income, net	*	*	*
Income tax benefit	*	1	1
Net (loss) income	(22)%	(4)%	5%

\* less than 1%

**COMPARISON OF YEARS ENDED DECEMBER 31, 2004 AND DECEMBER 31, 2003**

**Revenue:** Our revenue for the year ended December 31, 2004 was \$45,407,000 as compared to \$38,332,000 for the year ended December 31, 2003. The 18% increase in revenue was mainly due to increases in subscription revenues and advertising revenues.

The effects of consolidating eDiets Europe (as described in Note 5 to our consolidated financial statements) had a minimal impact on the results of operations for the year ended December 31, 2004. Revenues for eDiets Europe represented approximately 1% of consolidated revenues for the year ended December 31, 2004 while net loss represented less than 1% for the same period. We anticipate increased revenues from eDiets Europe in fiscal year 2005 with twelve months of operations versus fiscal year 2004 which only had 5.5 months of operations.

Membership revenue totaled approximately \$39,196,000 for the year ended December 31, 2004, an increase of 19% over membership revenue of \$32,935,000 in the prior year. The dollar increase in membership revenue was due to a combination of a higher average paying subscriber base combined with higher average weekly fees. Paying members as of December 31, 2004 were approximately 192,000 compared to 189,000 as of December 31, 2003. We expect continued growth in membership revenue due to a combination of increased subscribers and higher average weekly fees.



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Other revenues, consisting primarily of advertising revenue, commission revenue and e-commerce revenue, totaled approximately \$6,211,000 and \$5,397,000 for the years ended December 31, 2004 and 2003, respectively.

As of December 31, 2004, we had deferred revenue of \$5,844,000 relating to payments for which services had not yet been provided, compared to \$3,945,000 as of December 31, 2003. Deferred revenue as of December 31, 2004 includes \$2,368,000 of non-refundable fees received in July 2004 under a 15-year exclusive technology licensing agreement related to the Company's operations in the United Kingdom and Ireland. The remaining \$3,476,000 of deferred revenue as of December 31, 2004 related to subscription fees prepaid by members and which balance fluctuates depending on the amount of prepayment required by us under our various subscription plans.

Cost of Revenue: Cost of revenue consists primarily of credit card fees and revenue sharing or royalty costs. Other costs include Internet access fees, compensation for nutritional and consulting professionals and product and fulfillment costs for e-commerce sales. Cost of revenue increased to \$6,387,000 or 14% of revenues for the year

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**Table of Contents**

ended December 31, 2004 from \$4,701,000 or 12% of revenues for the year ended December 31, 2003. The dollar increase of 36% year over year was primarily due to increase of royalty payments under the exclusive license agreements with third party nutritional and fitness companies as mentioned above.

Product Development: Product development costs consist primarily of salary payments to our development staff and related expenditures for technology and software development. These expenses increased to \$2,507,000 or 6% of revenues for the year ended December 31, 2004 from \$1,581,000 or 4% of revenues for the year ended December 31, 2003. The 59% dollar increase for the year ended December 31, 2004 as compared to the prior year was primarily due to additional personnel costs related to creating and testing new design concepts and tools to be used throughout our Web sites.

Sales and Marketing Expense: Sales and marketing expenses consist primarily of Internet advertising expenses and compensation for employees in the sales and marketing group. Due to seasonality involved in the diet services business we traditionally experience higher sales and marketing expenses in the first half of the year versus the second half of the year. These expenses increased to \$39,936,000 or 88% of revenues for the year ended December 31, 2004 from \$28,199,000 or 73% of revenues for the year ended December 31, 2003. The dollar increase in sales and marketing expenses of 42% year over year was mainly due to the launch of television advertising in the first quarter of 2004 which continued throughout the year. Advertising expense totaled \$32.6 million in fiscal 2004, an increase of 46% over advertising expense of \$22.3 million in the prior year, primarily related to rate increases in the online advertising market and to the increase in our offline advertising in the current year.

We expect rates in the online advertising market to continue to increase in 2005. This trend could significantly impact our ability to place the amount of advertising required to aggressively grow our member base. We are in the process of developing alternative channels of customer acquisition, such as television advertising.

General and Administrative Expense: General and administrative expenses consist primarily of salaries, overhead and related costs for general corporate functions, including professional fees. General and administrative expenses increased to \$5,695,000 or 12% of revenues for the year ended December 31, 2004 from \$4,476,000 or 12% of revenues for the year ended December 31, 2003. The dollar increase of 27% year over year was primarily due to the result of increases in headcount, professional fees and general overhead.

Depreciation and Amortization: Depreciation and amortization expenses decreased to \$879,000 or 2% of revenues for the year ended December 31, 2004 from \$1,171,000 or 3% of revenues for the year ended December 31, 2003. The dollar decrease was mainly due to a lower base of intangible assets subject to amortization in 2004.

Impairment of Intangible Assets: During the second quarter of 2003, we recorded an impairment loss related to certain identifiable intangibles acquired in the October 2001 acquisition of DietSmart, Inc. (DietSmart), specifically the developed technology and DietSmart trade name. The loss was calculated in accordance with SFAS 142 and totaled approximately \$183,000. During the first quarter of 2004, we shut down the DietSmart website and commenced the process of encouraging the remaining DietSmart members to convert to eDiets memberships. As a result of shutting down the website, we recorded an impairment charge in our Consolidated Statement of Operations for the year ended December 31, 2004 of approximately \$54,000 related to the developed technology and trademarks and trade names intangibles.

Other Income, net: Other income, net which consists of interest income, interest expense and loss on disposal of fixed assets, increased to \$115,000 for the year ended December 31, 2004 from \$13,000 for the year ended December 31, 2003. The increase in other income, net, was primarily due to a higher average cash balance in the current year compared to the prior year.

Income Tax Benefit: Income tax benefit of \$33,000 for the year ended December 31, 2004 relates to the tax benefit from the amortization of intangible assets resulting from the DietSmart and eDiets Europe acquisitions. In the prior year we recorded approximately \$258,000 of income tax benefit related to the amortization of intangible assets resulting from the DietSmart acquisition.

## **Table of Contents**

We expect to be able to offset substantially all taxable income for at least the next fiscal year with available net operating loss carryforwards from prior years.

Net Loss: As a result of the factors discussed above, we recorded net loss of \$9,903,000 for the year ended December 31, 2004 compared to a net loss of \$1,708,000 for the year ended December 31, 2003.

## **COMPARISON OF YEARS ENDED DECEMBER 31, 2003 AND DECEMBER 31, 2002**

Revenue: Our revenue for the year ended December 31, 2003 was \$38,332,000 as compared to \$29,628,000 for the year ended December 31, 2002. The 29% increase in revenue was mainly due to price increases over the prior year. Paying members as of December 31, 2003 were approximately 189,000 compared to 180,000 as of December 31, 2002. The increase in paying members was primarily due to the introduction of exclusive licenses for the intellectual property associated with a variety of third party nutrition and fitness approaches and the offer of personalized versions of these approaches in addition to our own internally-developed plans. To date, we have obtained exclusive licenses to offer the Atkins Nutritional Approach, ZonePerfect Nutrition, *Shape Up!* inspired by Dr. Phil McGraw's book, *The Ultimate Weight Solution*, the Perricone Nutritional Face Lift and the Slim-Fast® personalized online program. Approximately 14% of our revenues in 2003 came from non-subscription based sources of revenue, such as advertising revenue, commission revenue and e-commerce revenue, compared to 11% in 2002.

As of December 31, 2003, we had deferred revenue of \$3,945,000 relating to payments for which services had not yet been provided, compared to \$3,081,000 as of December 31, 2002.

Cost of Revenue: Cost of revenue consists primarily of Internet access and service charges, credit card fees, consulting costs for professionals that provide online meetings, revenue sharing costs, advertising servicing fees, salary payments to our nutritional staff and product and fulfillment costs related to e-commerce sales. Cost of revenue increased to \$4,701,000 or 12% of revenues for the year ended December 31, 2003 from \$3,081,000 or 10% of revenues for the year ended December 31, 2002. The dollar increase of 53% year over year was primarily due to increased exclusive license agreements with third party nutritional and fitness companies as mentioned above.

Product Development: Product development costs consist primarily of salary payments to our development staff and related expenditures for technology and software development. These expenses increased to \$1,581,000 or 4% of revenues for the year ended December 31, 2003 from \$1,381,000 or 5% of revenues for the year ended December 31, 2002. The 14% dollar increase for the year ended December 31, 2003 as compared to the prior year was primarily due to additional personnel costs related to creating and testing new design concepts and tools to be used throughout our Web sites.

Sales and Marketing Expense: Sales and marketing expenses consist primarily of Internet advertising expenses and compensation for employees in the sales and marketing group. These expenses increased to \$28,199,000 or 73% of revenues for the year ended December 31, 2003 from \$17,640,000 or 59% of revenues for the year ended December 31, 2002. The dollar increase in sales and marketing expenses of 60% year over year was primarily due to an increase of our online advertising efforts in the current year. Advertising expense totaled \$22.3 million in fiscal 2003, an increase of 73% over advertising expense of \$12.9 million in the prior year.

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General and Administrative Expense: General and administrative expenses consist primarily of salaries, overhead and related costs for general corporate functions, including professional fees. General and administrative expenses decreased to \$4,476,000 or 12% of revenues for the year ended December 31, 2003 from \$4,660,000 or 16% of revenues for the year ended December 31, 2002. The dollar decrease of 4% year over year was primarily due to the result of decrease in professional fees offset by increases in general overhead.

Depreciation and Amortization: Depreciation and amortization expenses decreased to \$1,171,000 or 3% of revenues for the year ended December 31, 2003 from \$1,321,000 or 4% of revenues for the year ended December 31, 2002. The dollar decrease was mainly due to the intangible asset impairment during the second quarter of 2003, for which we recorded an impairment charge of approximately \$183,000 (see below).

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## **Table of Contents**

**Impairment of Intangible Assets:** During the second quarter of 2003, we recorded an impairment loss related to certain identifiable intangibles acquired in the October 2001 acquisition of DietSmart, Inc. (DietSmart), specifically the developed technology and DietSmart trade name. The loss was calculated in accordance with SFAS 144 and totaled approximately \$183,000.

**Other Income (Expense), net:** Other income (expense), net which consists of interest income, interest expense and loss on disposal of fixed assets, increased from an expense of \$172,000 in the prior year to income of \$13,000 for the year ended December 31, 2003. The increase in other income, net, was primarily due to the prior year's interest expense incurred in connection with the notes payable issued as a part of the acquisition of DietSmart in October 2001. These notes were paid in January 2003.

**Income Tax Benefit:** Income tax benefit for the two years ended December 31, 2003 relates to the tax benefit from the amortization of intangible assets resulting from the DietSmart acquisition.

**Net (Loss) Income:** As a result of the factors discussed above, we recorded net loss of \$1,708,000 for the year ended December 31, 2003 compared to net income of \$1,624,000 for the year ended December 31, 2002.

## **LIQUIDITY AND CAPITAL RESOURCES**

**Cash Flows from Operating Activities:** During 2004, we generated negative operating cash flow of \$7,632,000. These cash flows primarily related to our net loss of \$9,903,000, adjusted for, among other things, non-cash charges, including depreciation and amortization of \$879,000, provision of bad debt of \$139,000 and an aggregate increase in cash flows from our operating assets and liabilities of \$1,195,000. During 2003, we generated positive operating cash flow of \$2,917,000. These cash flows primarily related to an aggregate increase from our operating assets and liabilities of \$3,391,000 and non-cash charges, including depreciation and amortization of \$1,171,000 and loss on impairment of intangibles of \$256,000, adjusted for, among other things, our net loss of \$1,708,000 and deferred tax benefit of \$261,000.

**Cash Flows from Investing Activities:** Our investing activities provided for \$2,064,000 for the year ended December 31, 2004 and used \$677,000 for the prior year. The \$2,064,000 of net cash provided in 2004 was primarily attributable to the acquisition of the minority interest of eDiets Europe and the effect of consolidation of this previously unconsolidated subsidiary, offset by the purchases of computer equipment and software development costs. The \$677,000 of net cash used in 2003 was primarily for purchases of computer equipment and software development costs.

**Cash Flows from Financing Activities:** Our financing activities provided for \$8,348,000 and \$1,679,000 for the years ended December 31, 2004 and 2003, respectively. The cash provided in 2004 was primarily attributable to \$6,485,000 in net proceeds from the issuance of common stock in April 2004 with the remainder proceeds from the exercise of stock options and warrants throughout the year. The cash provided in 2003 was primarily attributable to proceeds from the exercise of stock options and warrants offset by the repayment of notes payable issued in connection with the acquisition of DietSmart and the repayment of capital lease obligations. As of December 31, 2004, our debt totaled \$133,000 and consists of capital lease obligations.

**Available Cash:** At December 31, 2004, we had unrestricted cash and cash equivalents of \$8,787,000. Management believes that cash on hand and cash flows from operations will be sufficient to fund its working capital and capital expenditures for at least the next twelve months. To the extent we require additional funds to support our operations or the expansion of our business, we may seek to undertake additional equity financing. There can be no assurance that additional financing, if required, will be available to us in amounts or on terms acceptable to us or at

all.

**Table of Contents**

Contractual Obligations: The following summarizes future cash outflow related to our non-cancelable contractual obligations at December 31, 2004 (in thousands):

	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>After 3 years</u>
Contractual obligations:				
Capital lease obligations	\$ 144	\$ 106	\$ 38	\$
Operating leases	306	182	124	
Online advertising with major internet portals	13,165	13,165		
Television advertising	4,324	4,324		
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total contractual cash obligations	\$ 17,939	\$ 17,777	\$ 162	\$
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**CRITICAL ACCOUNTING POLICIES**

We have identified the policies outlined below as critical to our business operations and an understanding of our results of operations. The listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see the Notes to the Consolidated Financial Statements. Note that our preparation of the financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

REVENUE RECOGNITION:

We offer subscriptions to the proprietary content contained in our Web sites. Revenues from customer subscriptions represent the majority of our business and are paid in advance mainly via credit cards. Subscriptions to our nutrition, fitness, support and recipe plans are paid in advance and cash receipts are deferred and recognized as revenue on a straight-line basis over the period of the subscription.

In accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, we recognize gross subscription revenues associated with licensed diet and fitness plans based on the relevant facts of the related license agreements, while the license fee incurred to the licensor is included in cost of revenues.

We collect customer subscription amounts in advance and maintain a reserve for refunds related to cancelable plans. Under cancelable plans, customers are entitled to cancel their memberships after an initial length of stay and receive a full refund for the unused portion of the membership.



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Advertising revenue is recognized in the period the advertisement is displayed, provided that no significant Company obligations remain and collection is probable. Our obligations typically include guarantees of a minimum number of impressions or times that visitors to our Web site view an advertisement. Amounts received or billed for which impressions have not yet been delivered are reflected as deferred revenue. Opt-in email revenue is derived from the sale of email addresses of visitors to our Web sites who have authorized us to allow third party solicitations. Revenues from the sale of email addresses are recognized when no significant obligation remains and collection is probable.

E-commerce revenue is currently derived from the sale of motivational audio tapes or compact discs, journals, pedometers, starter kits and other bundled products to consumers. Revenues from the sales of those products are recognized when the product is shipped.

## Table of Contents

Commission revenue is derived from third party vendors whose products are sold on our Web sites. Commission revenue is recognized when the third party vendor ships the product and collection is probable.

Royalty revenue is derived from the 15-year exclusive technology licensing agreement related to the Company's operations in the United Kingdom and Ireland and is being recognized on a straight-line basis over the term of the agreement.

### GOODWILL AND INTANGIBLE ASSETS:

We recorded goodwill and intangible assets in connection with the acquisition of eDiets Europe. With the assistance of an independent valuation expert, we determined the fair market values of the intangible assets acquired, which consisted of a technology licensing agreement, subscriber base, email address list and developed technology.

The value of the technology licensing agreement was determined by using the income approach and calculating the expected cash flows under the agreement over the expected life of 15 years.

The value of the subscriber base and email address list was determined by using the income approach and calculating the expected cash flows from existing customer relationships over the expected life of 20 and 30 months, respectively.

The value of the developed technology was determined by using the cost approach by estimating the costs to replace the existing websites less obsolescence and with an expected life of seven years.

We also recorded goodwill and intangible assets in the fourth quarter of 2001 in connection with the acquisition of DietSmart, Inc. With the assistance of an independent valuation expert, we determined the fair market values of the intangible assets acquired, which consisted of mailing lists, developed technology and trademarks and trade names.

The value of the mailing list was determined by calculating its cash flow generating capacity over the expected two year economic life of the list and was fully amortized at December 31, 2003.

The value of trademarks and trade names, which originally had an estimated life of three years, was based on management's intention to use the DietSmart website as a platform to potentially test new marketing and services, while at the same time using the DietSmart website to direct traffic to the eDiets website.

During the first quarter of 2004 the Company shut down the DietSmart website and commenced the process of encouraging the remaining DietSmart members to convert to the eDiets.com website. As a result of the shutting down of the website the Company, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, recorded an

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impairment charge in its Consolidated Statement of Operations for the year ended December 31, 2004 of approximately \$54,000 related to the developed technology and trademarks and trade names intangibles.

We adopted SFAS 142, *Goodwill and Other Intangible Assets*, as of January 1, 2002. Under SFAS 142, goodwill and indefinite lived intangible assets are no longer amortized, but must be reviewed for impairment at least annually or sooner under certain circumstances. We perform our annual impairment test on October 1 of each year. We reviewed the goodwill recorded on our books as of January 1, 2002, October 1, 2002, October 1, 2003 and October 1, 2004 in accordance with SFAS 142 and have determined that no impairment exists. Our evaluation of goodwill recorded in connection with the acquisition of eDiets Europe was tested at the reportable segment level which is based on a review of estimated future cash flows of the entity. Our evaluation of goodwill recorded in connection with the acquisition of DietSmart was done at the enterprise level which compares the goodwill recorded to the market capitalization of the Company. As of December 31, 2004, we had goodwill of \$5.2 million related to the DietSmart acquisition and \$2.0 million related to the eDiets Europe acquisition.

### ACCOUNTING FOR EQUITY INVESTMENT:

In November 2000, we acquired a 60% interest in eDiets Europe in exchange for the license of our international technology rights. We used the equity method of accounting for this investment, as opposed to consolidating the results, since we did not control the operation due to the substantive participating rights of the minority investor, including approval of significant operating decisions and approval of the annual operating budget. Since we had not invested any cash nor had we made any commitments to fund the entity, we did not record any losses for eDiets

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**Table of Contents**

Europe through July 14, 2004. On July 15, 2004, we acquired the remaining 40% interest in eDiets Europe for a combination of cash and common stock valued at approximately \$2.3 million in total. As a result, eDiets Europe became a wholly-owned subsidiary of the Company and the accounts and results since July 15, 2004 are included in the Company's consolidated financial statements.

**ACCOUNTING FOR EMPLOYEE STOCK-BASED COMPENSATION:**

We account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, establishes accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. We are generally not required under APB Opinion No. 25 to recognize compensation expense in connection with our employee stock option plans. We are required by SFAS No. 123, as amended by SFAS No. 148, to present, in the Notes to our Consolidated Financial Statements, the pro forma effects on reported net income and earnings per share as if compensation expense had been recognized based on the fair value method of accounting prescribed by SFAS No. 123.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R, *Share-Based Payment*. SFAS No. 123R requires companies to expense the value of employee stock options and similar awards. SFAS No. 123R is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. SFAS No. 123R permits public companies to adopt its requirements using one of two methods: A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. A prospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123R for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. We are currently in the process of determining the effects on our financial position, results of operations and cash flows that will result from the adoption of SFAS No. 123R.

**ACCOUNTING FOR INCOME TAXES:**

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our net deferred tax assets. We have recorded a full valuation allowance as of December 31, 2004, due to uncertainties related to our ability to utilize our deferred tax assets, primarily consisting of certain net operating losses carried forward, before they expire. The valuation allowance is based on our estimates of taxable income and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates, or we adjust these estimates in future periods, we may need to establish an additional valuation allowance which could materially impact our financial position and results of operations.



**Table of Contents**

**CERTAIN FACTORS WHICH MAY AFFECT FUTURE RESULTS**

In addition to other information in this report, the following factors should be considered in evaluating our condition and prospects. These factors may have a significant impact on our future operating results.

**WE DEPEND ON MAJOR INTERNET PORTALS TO ATTRACT USERS TO OUR WEBSITE, AND OUR BUSINESS WOULD BE ADVERSELY AFFECTED IF OUR ADVERTISING IS DISCONTINUED ON THESE PORTALS.**

A significant portion of our online traffic has come, and we believe will continue to come from agreements with Internet portals such as MSN, AOL and others that expire at various times in 2005. Online advertising rates increased markedly in 2004 and we expect this trend could continue in 2005. Consequently, there is no assurance that these contracts will be renewed at terms and conditions similar to those that are expiring. This trend could significantly impact our ability to place the amount of advertising required to aggressively grow our member base. Our other current advertising agreements are on a short term (less than three months) basis. Our other advertising partners have no obligation to renew our agreements under the same terms and conditions when they expire. Our agreements with these advertisers also do not prohibit them from carrying online sites or developing and providing content that competes with our site. If our advertising is discontinued for any reason on one or more of the major portals on which we currently advertise and we are not able to develop alternative channels of customer acquisition, our revenue and results of operations would be adversely affected.

**WE DEPEND ON DAVID R. HUMBLE, OUR FOUNDER AND CHIEF EXECUTIVE OFFICER, AND OUR OTHER KEY MANAGEMENT PERSONNEL, AND THE LOSS OF THEIR SERVICES COULD HARM OUR BUSINESS. AS THE LARGEST STOCKHOLDER (35%), MR. HUMBLE ALSO HAS SIGNIFICANT INFLUENCE OVER OUR COMPANY.**

Our business is dependent on David R. Humble, our founder and Chief Executive Officer, and other key management personnel. Although we have an employment agreement with Mr. Humble, our business would suffer if we were to lose his services. Under our employment agreement, Mr. Humble receives a base salary of \$250,000 per year and a bonus to be determined by our compensation committee based on our income before taxes. The employment agreement contains a non-compete provision for the term of employment and two years thereafter, as well as a non-disclosure provision.

The success of our business will also depend on our ability to hire and retain additional qualified key executive management personnel particularly in the marketing, administrative and financial areas. Competition for qualified personnel in the Internet industry is intense. If we are unable to attract and retain additional qualified personnel, our business could suffer.

Mr. Humble owns approximately 35% of our outstanding voting common stock. Therefore, as a practical matter, he is able to influence the outcome of all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. Among other things, concentration of control in one stockholder may discourage potential investors from providing additional financing if we need it.

**WE CAN T BE CERTAIN THAT ADDITIONAL FINANCING WILL BE AVAILABLE TO US ON ACCEPTABLE TERMS IF WE NEED IT.**

We believe that cash on hand and cash flows from operations will be sufficient to meet our anticipated capital needs through at least the next 12 months. However, due to unforeseen circumstances, unanticipated changes in our plans or other factors beyond our control, we may require additional financing. Our business could suffer if financing is not available when we may require it or if it is only available on unfavorable terms.

**Table of Contents**

BECAUSE OF OUR LIMITED OPERATING HISTORY WE MAY FAIL TO MANAGE OUR EXPANSION AND EXPECTED GROWTH EFFECTIVELY, WHICH COULD STRAIN OUR RESOURCES AND COULD IMPAIR THE EXPANSION OF OUR BUSINESS.

Although we have continued to grow our revenues, a failure to manage our growth effectively could adversely affect our ability to attract and retain our members and advertising partners. We have increased the scope of our operations, including our technology, sales, administrative and marketing organizations. These factors have placed and will continue to place a significant strain on our management systems and resources. We will need to continue to improve our operational, financial and managerial controls and reporting systems and procedures to expand, train and manage our workforce in order to manage our expected growth.

WE FACE SIGNIFICANT COMPETITION.

We currently compete with several non-Internet weight-loss companies. Our major competitor is Weight Watchers® International, Inc. We also compete with a number of Internet sites which provide diet and nutrition information. Currently, we know of several other online competitors aggressively marketing an online program with similarities to our program.

Due to the success of our program and the development of other competitive online weight-loss programs, we anticipate that the industry leaders will continue to mount a meaningful form of Internet response. Increased competition could result in reductions in the prices we receive for our programs, lower margins, loss of customers and reduced visitor traffic to our Web site.

Several of our existing competitors and potential competitors have longer operating histories, greater name recognition and significantly greater financial, technical and marketing resources and may be able to devote greater resources than we can for the development and promotion of their services and products. These competitors may also engage in more extensive marketing and advertising efforts, adopt more aggressive pricing policies and make more attractive offers to advertisers and alliance partners. Accordingly, we may not be able to compete successfully.

Some competitors may attempt to emulate our strategy of obtaining exclusive licenses for the intellectual property associated with a variety of third party nutrition and fitness approaches and to offer personalized versions of these approaches. If this happens, or if we are otherwise unable to obtain or continue relationships with providers of third party nutrition or fitness approaches, our business may suffer.

WE PLAN TO INCREASE OUR INTERNATIONAL SALES ACTIVITIES, WHICH WILL SUBJECT US TO ADDITIONAL BUSINESS RISKS.

An element of our growth strategy is to expand our online marketing services in international markets in conjunction with eDiets Europe. Our participation in international markets will be subject to certain risks, such as:

difficulties in staffing and managing foreign operations;



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fluctuations in foreign currency exchange rates;

compliance with foreign regulatory and market requirements;

variability of foreign economic and political conditions;

changing restrictions imposed by regulatory requirements, tariffs or other trade barriers;

costs of localizing products and marketing such products in foreign countries;

potentially adverse tax consequences, including restrictions on repatriation of earnings;

difficulties in protecting intellectual property; and

burdens of complying with a wide variety of foreign laws.

To the extent our potential international members are subject to currency devaluations, general economic crises or other negative economic events, the ability of our members to utilize our services could be diminished.

**Table of Contents**

WE DEPEND HEAVILY ON OUR NETWORK INFRASTRUCTURE AND ITS FAILURE COULD RESULT IN UNANTICIPATED EXPENSES AND PREVENT OUR MEMBERS FROM EFFECTIVELY UTILIZING OUR SERVICES, WHICH COULD NEGATIVELY IMPACT OUR ABILITY TO ATTRACT AND RETAIN MEMBERS AND ADVERTISERS.

Our ability to successfully create and deliver our content depends in large part on the capacity, reliability and security of our networking hardware, software and telecommunications infrastructure. Failures of our network infrastructure could result in unanticipated expenses to address such failures and could prevent our members from effectively utilizing our services, which could prevent us from retaining and attracting members and advertisers. The hardware infrastructures on which our system operates are located in Sterling, Virginia and Miami, Florida. We are in the process of implementing a formal disaster recovery plan, however, our system is susceptible to natural and man-made disasters, including war, terrorism, hurricanes, fires, floods, power loss and vandalism. Further, telecommunications failures, computer viruses, electronic break-ins or other similar disruptive problems could adversely affect the operation of our systems. Our insurance policies may not adequately compensate us for any losses that may occur due to any damages or interruptions in our systems. Accordingly, we could incur capital expenditures in the event of unanticipated damage.

In addition, our members depend on Internet service providers, or ISPs, for access to our Web site. In the past, ISPs and Web sites have experienced significant system failures and could, in the future, experience outages, delays and other difficulties due to system failures unrelated to our systems. These problems could harm our business by preventing our members from effectively utilizing our services.

THE UNAUTHORIZED ACCESS OF CONFIDENTIAL MEMBER INFORMATION THAT WE TRANSMIT OVER PUBLIC NETWORKS COULD ADVERSELY AFFECT OUR ABILITY TO ATTRACT AND RETAIN MEMBERS.

Our members transmit confidential information to us over public networks, and the unauthorized access of such information by third parties could harm our reputation and significantly hinder our efforts to attract and retain members. We rely on a variety of security techniques and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology we use to protect customer transaction data and adversely affect our ability to attract and retain customers.

PROBLEMS WITH THE PERFORMANCE AND RELIABILITY OF THE INTERNET INFRASTRUCTURE COULD ADVERSELY AFFECT THE QUALITY AND RELIABILITY OF THE SERVICES WE OFFER OUR MEMBERS AND ADVERTISERS.

We depend significantly on the Internet infrastructure to deliver attractive, reliable and timely e-mail messages to our members. If Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by this growth, and its performance and reliability may decline, which could adversely affect our ability to sustain revenue growth. Among other things, continued development of the Internet infrastructure will require a reliable network backbone with necessary speed, data capacity and security. Currently, there are regular failures of the Internet network infrastructure, including outages and delays, and the frequency of these failures may increase in the future. These failures may reduce the benefits of our services to our members and undermine our advertising partners' and our members' confidence in the Internet as a viable commercial medium. In addition, the Internet could lose its viability as a commercial medium due to delays in the development or adoption of new technology required to accommodate increased levels of Internet activity or due to government regulation. These factors could adversely affect our business by adversely affecting the quality and reliability of the services we offer our customers.

## **Table of Contents**

WE MAY HAVE TO LITIGATE TO PROTECT OUR RIGHTS OR TO DEFEND CLAIMS BROUGHT AGAINST US BY THIRD PARTIES, AND SUCH LITIGATION MAY SUBJECT US TO SIGNIFICANT LIABILITY AND BE TIME CONSUMING AND EXPENSIVE.

We face a substantial risk of litigation, including litigation regarding intellectual property rights in Internet-related businesses. Legal standards relating to the validity, enforceability and scope of protection of certain proprietary rights in Internet-related businesses are uncertain and still evolving. We may have to litigate in the future to enforce our intellectual property rights, protect our trade secrets or defend ourselves against claims of violating the proprietary rights of third parties.

We also face the risk of having to defend against lawsuits brought by third parties related to our business activities. If the outcome of these proceedings, or similar proceedings that we may face in the future, were to make certain types of advertising unavailable to us, then our marketing may become less effective and our financial results could suffer.

Any of this type of litigation may subject us to significant liability for damages, result in invalidation of our proprietary rights, be time-consuming and expensive to defend, even if not meritorious, and result in the diversion of management time and attention. Any of these factors could adversely affect our business operations and financial results and condition.

GOVERNMENT REGULATION AND LEGAL UNCERTAINTIES OF DOING BUSINESS ON THE INTERNET COULD SIGNIFICANTLY INCREASE OUR COSTS AND EXPENSES.

Laws and regulations that apply to Internet communications, commerce and advertising are becoming more prevalent and these laws and regulations could significantly increase the costs we incur in using the Internet to conduct our business. The United States Congress enacted Internet legislation regarding children's privacy, copyright and taxation. The European Union has recently adopted a directive addressing data privacy that may result in limits on the collection and use of member information. A number of other laws and regulations may be adopted that regulate the use of the Internet, including user privacy, pricing, acceptable content, taxation, use of the telecommunications infrastructure and quality of products and services. The laws governing the Internet remain largely unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws, including those governing intellectual property, privacy, libel and taxation apply to the Internet and Internet advertising. In addition, the growth and development of the market for Internet commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business over the Internet. As a result of these uncertainties, we may incur unanticipated, significant costs and expenses that could harm our financial results and condition.

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

### **Interest Rate Risk**

Our exposure to interest rate risk relates primarily to our investment portfolio. Investments are made in accordance with our investment policy and consist of high grade commercial paper. We do not use derivative financial instruments to hedge against interest rate risk as all investments are the form of held-to-maturity securities with an original maturity of three months or less. Due to the short-term nature of these financial instruments the interest rate risk is deemed to be low. We estimate that the cost of these financial instruments approximates fair value at

December 31, 2004.

**Foreign Currency Risk**

We are exposed to foreign currency risk associated with certain sales transactions being denominated in Euros and British Sterling Pounds and fluctuations of the Euro and British Sterling Pounds as the financial position and operating results of the our foreign subsidiaries are translated into U.S. Dollars for consolidation. The Company has not implemented a hedging strategy to reduce foreign currency risk.

**Table of Contents**

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

Our financial statements, together with the report of Ernst & Young LLP, independent registered public accounting firm, appear at pages F-1 through F-23 of this report.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

Our Chief Executive Officer and Chief Financial Officer (collectively, the Certifying Officers ) are responsible for establishing and maintaining our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). These officers have concluded (based upon their evaluation of these controls and procedures as of the end of the period covered by this report) that our disclosure controls and procedures are effective and designed to ensure that information required to be disclosed by us in this report is accumulated and communicated to management, including our principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers also have indicated that there was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation of our internal control that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting

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

**ITEM 9B. OTHER INFORMATION**

None



**Table of Contents**

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

We have adopted a Code of Business Conduct and Ethics, which applies to all of our directors, officers and employees. A copy of this code is publicly available on our website at <http://www.eDiets.com> under the caption Investor Relations. We intend to make all required disclosures concerning amendments to, or waivers from, this code on our website or in a report on Form 8-K.

We incorporate information regarding our directors and executive officers into this section by reference from the sections entitled Election of Directors, Additional Information, Corporate Governance, and Section 16(a) Beneficial Ownership Reporting Compliance.

**ITEM 11. EXECUTIVE COMPENSATION**

We incorporate information regarding the compensation of our directors and executive officers into this section by reference from the sections entitled Election of Directors and Additional Information in the proxy statement for our 2005 Annual Meeting of Stockholders.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

We incorporate information regarding the ownership of our securities of our directors, executive officer and 5% stockholders into this section by reference from the section entitled Additional Information in the proxy statement for our 2005 Annual Meeting of Stockholders.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

We incorporate information regarding transaction with related parties into this section by reference from the section entitled Certain Relationships and Related Transactions in the proxy statement for our 2005 Annual Meeting of Stockholders.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

We incorporate information regarding our audit committee's pre-approval policies and procedures and the fees paid to our auditors from the section entitled Independent Auditors and Fees in the proxy statement for our Annual Meeting of Stockholders.





**Table of Contents**

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

**(a) 1. CONSOLIDATED FINANCIAL STATEMENTS.**

For a list of the consolidated financial information included herein, see Index on Page F-1.

**2. FINANCIAL STATEMENT SCHEDULES.**

The following consolidated financial statement schedule is included in Item 8:

*Valuation and Qualifying Accounts*

**3. LIST OF EXHIBITS.**

**EXHIBIT NO. DESCRIPTION**

3.1	Restated Certificate of Incorporation (1)
3.2	By-Laws (1)
3.3	Certificate of Amendment dated July 24, 2001 to Certificate of Incorporation (5)
4.1	Warrant dated January 8, 2001 issued to Mallory Factor (3)
4.2	Warrant Certificate dated November 17, 1999 issued to Whale Securities Co., L.P. for 570,625 warrants (1)
4.2.2	Warrant Certificate dated December 23, 1999 issued to Whale Securities Co., L.P. for 70,000 warrants (1)
4.3	Form of Registrant s common stock Certificate (1)
4.4	Form of Registration Rights Agreement (1)
4.5	Warrant Agreement dated November 17, 1999 between Registrant and Whale Securities Co., L.P. (1)
4.6	Warrant Certificate dated March 28, 2001 issued to Whale Securities Co. LP for 460,634 warrants (5)
4.7	Warrant Certificate dated March 28, 2001 issued to Matthew A. Gohd for 415,220 warrants (5)
4.8	Warrant Certificate dated March 28, 2001 issued to Matthew Drillman for 14,829 warrants (5)
4.9	Warrant Certificate dated March 28, 2001 issued to Renee Russnok for 14,829 warrants (5)
4.10	Registration Rights Agreement, dated October 19, 2001 by and among eDiets.com, Inc., Tamara L. Totah, Carlos M. Lopez-Ona and Andrew G. Smith (6)

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- 4.11 Registration Rights Agreement, dated as of April 12, 2004, by and among eDiets.com, Inc. and the investors named therein (7)
- 4.12 Form of Additional Investment Right (7)
- 10.1 Employment Agreement dated November 17, 1999 between Registrant and David R. Humble\*\* (1)

**Table of Contents**

10.2	Revised Form of Indemnification Agreement between the Registrant and each of its Directors and Executive Officers** (1)
10.3	Agreement and Plan of Merger and Reorganization dated as of August 30, 1999 among the Registrant, eDiets Acquisition Corp., eDiets.com, Inc. and David R. Humble (1)
10.4	License Agreement dated August 3, 1999 between eDiets, Inc. (formerly eDiets.com, Inc.) and David R. Humble (1)
10.5	Placement Agent Agreement dated November 17, 1999 between the Registrant and Whale Securities Co., L.P. (1)
10.6	Joint Venture Agreement dated November 28, 2000 between Registrant, Unislim Ireland, Ltd. and eDiets Europe, Ltd. (2)
10.7	Technology License Agreement dated November 28, 2000 between eDiets British Virgin Islands, Inc. and eDiets Europe, Ltd. (2)
10.8	Purchase and Sale Agreement dated November 22, 2000 between Registrant and eDiets, BVI, Inc. (2)
10.9	Agreement dated March 29, 2001 between the Registrant and Microsoft Corporation (3)(4)
10.10	Agreement dated March 28, 2001 between the Registrant, Whale Securities Co., L.P., Matthew Gohd, Matthew Drillman, Leslie Wilson, Craig Schwabe, and Renee Russnok (3)
10.11	Arrangement Letter dated January 29, 2001 between the Registrant and Mallory Factor, Inc. (3)
10.12	Land and building lease agreement dated July 19, 2001 between Realty Income Corporation and Registrant (5)
10.13	Securities Purchase Agreement, dated as of April 12, 2004, by and among eDiets.com, Inc., Mr. David R. Humble and the investors named therein (7)
21.1	Subsidiaries of the Registrant.*
23.1	Consent of Independent Registered Public Accounting Firm.*
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, Section 906 of the Sarbanes-Oxley Act of 2002.*

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(1) Incorporated by reference to the Registration Statement on Form SB-2 as filed with the SEC on December 30, 1999 or Amendment No. 1 thereto filed on March 20, 2000 or Amendment No. 2 thereto filed on April 17, 2000 (File No. 333-93971).

**Table of Contents**

- (2) Incorporated by reference to the Registrant's Form 10-KSB for the year ended December 31, 2000 and filed with the SEC on April 2, 2001.
  - (3) Incorporated by reference to the Registrant's Form 10-QSB for the quarterly period ended March 31, 2001 and filed with the SEC on May 14, 2001.
  - (4) Confidential treatment requested pursuant to Rule 24B-2 promulgated under the Securities and Exchange Act of 1934. Confidential portions of this document have been redacted and have been filed separately with the SEC.
  - (5) Incorporated by reference to the Registration Statement on Form SB-2 as filed with the SEC on May 31, 2001 or Amendment No. 1 thereto filed on July 2, 2001 or Amendment No. 2 thereto filed on August 6, 2001 (File No. 333-62046).
  - (6) Incorporated by reference to the Registrant's Form 8-K filed with the SEC on November 2, 2001.
  - (7) Incorporated by reference to the Registrant's Form 8-K filed with the SEC on April 14, 2004.
- \* Filed herewith  
\*\* Management contract or compensatory plan or arrangement

**(b) EXHIBITS.**

The Company files as part of this Form 10-K the exhibits listed in Item 15(a)(3) above.

**(c) FINANCIAL STATEMENT SCHEDULE**

The Company files as part of this Form 10-K the consolidated financial schedule listed in Item 15(a)(2) above, which is attached hereto.

**Table of Contents**

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 22, 2005

eDiets.com, Inc., a Delaware corporation

By: /s/ David R. Humble

\_\_\_\_\_  
 David R. Humble, Chairman of the Board  
 and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b><u>SIGNATURE</u></b>	<b><u>CAPACITY</u></b>	<b><u>DATE</u></b>
_____ /s/ David R. Humble	Chairman of the Board and	March 22, 2005
David R. Humble	Chief Executive Officer  (Principal Executive Officer and Director)	
_____ /s/ Ciaran G. McCourt	Director, President and Chief Operating Officer	March 22, 2005
Ciaran G. McCourt		
_____ /s/ Robert T. Hamilton	Chief Financial Officer	March 22, 2005
Robert T. Hamilton	(Principal Financial and Accounting Officer)	
_____ /s/ Lee S. Isgur	Director	March 22, 2005
Lee S. Isgur		
_____ /s/ Pedro N. Ortega-Dardet	Director	March 22, 2005
Pedro N. Ortega-Dardet		
_____ /s/ Ronald Luks	Director	March 22, 2005
Ronald Luks		

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<u>/s/ Andrea M. Weiss</u>	Director	March 22, 2005
Andrea M. Weiss		
<u>/s/ Robert L. Doretti</u>	Director	March 22, 2005
Robert L. Doretti		

**Table of Contents**

**EDIETS.COM, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

The following consolidated financial statements of eDiets.com, Inc. are included in Item 8:

<u>Report of Independent Registered Public Accounting Firm</u>	F-1
<u>Consolidated Balance Sheets December 31, 2004 and 2003</u>	F-2
<u>Consolidated Statements of Operations Years ended December 31, 2004, 2003 and 2002</u>	F-3
<u>Consolidated Statements of Stockholders Equity Years ended December 31, 2004, 2003 and 2002</u>	F-4
<u>Consolidated Statements of Cash Flows Years ended December 31, 2004, 2003 and 2002</u>	F-5
<u>Notes to Consolidated Financial Statements December 31, 2004</u>	F-6

The following consolidated financial statement schedule of eDiets.com, Inc. is included in Item 15(a):

<u>Schedule II Valuation and Qualifying Accounts</u>	F-23
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All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

eDiets.com, Inc.

We have audited the accompanying consolidated balance sheets of eDiets.com, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of eDiets.com, Inc. at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Certified Public Accountants

Ft. Lauderdale, Florida

February 11, 2005



**Table of Contents****EDIETS.COM, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands)**

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 8,787	\$ 6,063
Accounts receivable, net	1,094	970
Prepaid advertising costs	349	118
Prepaid expenses and other current assets	559	351
<b>Total current assets</b>	<b>10,789</b>	<b>7,502</b>
Restricted cash		202
Property and equipment, net	1,317	1,120
Intangibles, net	758	80
Goodwill	7,212	5,191
Other assets	64	48
<b>Total assets</b>	<b>\$ 20,140</b>	<b>\$ 14,143</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 4,769	\$ 2,139
Accrued liabilities	3,731	1,584
Reserve for refunds	272	344
Current portion of capital lease obligations and notes payable	97	84
Deferred revenue	3,476	3,945
<b>Total current liabilities</b>	<b>12,345</b>	<b>8,096</b>
Capital lease obligations and notes payable, net of current portion	36	67
Deferred revenue	2,368	
Deferred tax liability	95	30
Commitments and contingencies		
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$.01 par value 1,000 shares authorized, no shares issued and outstanding		
Common stock, \$.001 par value 50,000 shares authorized, 21,217 and 18,142 shares issued and outstanding at December 31, 2004 and 2003, respectively	21	18
Additional paid-in capital	21,371	12,176
Unearned compensation	(72)	(115)
Accumulated other comprehensive income	8	
Accumulated deficit	(16,032)	(6,129)
<b>Total stockholders equity</b>	<b>5,296</b>	<b>5,950</b>

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Total liabilities and stockholders' equity	\$ 20,140	\$ 14,143
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*The accompanying notes are an integral part of these consolidated financial statements.*

F-2

**Table of Contents****EDIETS.COM, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

	Year Ended December 31,		
	2004	2003	2002
REVENUE	\$ 45,407	\$ 38,332	\$ 29,628
COSTS AND EXPENSES:			
Cost of revenue	6,387	4,701	3,081
Product development	2,507	1,581	1,381
Sales and marketing	39,936	28,199	17,640
General and administrative	5,695	4,476	4,660
Depreciation and amortization	879	1,171	1,321
Impairment of intangible assets	54	183	
Total costs and expenses	55,458	40,311	28,083
(Loss) income from operations	(10,051)	(1,979)	1,545
Other income (expense), net	115	13	(172)
(Loss) income before income tax benefit	(9,936)	(1,966)	1,373
Income tax benefit	33	258	251
Net (loss) income	\$ (9,903)	\$ (1,708)	\$ 1,624
(Loss) earnings per common share:			
Basic	\$ (0.49)	\$ (0.10)	\$ 0.10
Diluted	\$ (0.49)	\$ (0.10)	\$ 0.09
Weighted average common and common equivalent shares outstanding:			
Basic	20,091	16,675	15,730
Diluted	20,091	16,675	17,132

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

**Table of Contents****EDIETS.COM, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(In thousands)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	UNEARNED COMPENSATION	ACCUMULATED OTHER COMPREHENSIVE INCOME		ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS EQUITY
	SHARES	AMOUNT						
Balance at January 1, 2002	15,503	\$ 16	\$ 9,644	\$ (2)	\$	\$ (6,045)	\$ 3,613	
Retirement of common stock previously issued	(30)		(67)				(67)	
Stock options and warrants granted and vested			77	2			79	
Stock options and warrants exercised	319		91				91	
Common stock registration costs			(54)				(54)	
Net income						1,624	1,624	
Balance at December 31, 2002	15,792	16	9,691	(115)		(4,421)	5,286	
Stock options granted and vested			129	(115)			14	
Stock options exercised with stock	13		37				37	
Stock options and warrants exercised	2,337	2	2,342				2,344	
Common stock registration costs			(23)				(23)	
Net loss						(1,708)	(1,708)	
Balance at December 31, 2003	18,142	18	12,176	(115)		(6,129)	5,950	
Stock options vested				43			43	
Stock options and warrants exercised	1,217	1	1,984				1,985	
Common stock issued in private placement	1,602	2	7,046				7,048	
Common stock issued for acquisition	256		726				726	
Common stock registration costs			(561)				(561)	
Foreign currency translation					8		8	
Net loss						(9,903)	(9,903)	
Balance at December 31, 2004	21,217	\$ 21	\$ 21,371	\$ (72)	\$ 8	\$ (16,032)	\$ 5,296	

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



**Table of Contents****EDIETS.COM, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Year Ended December 31,		
	2004	2003	2002
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net (loss) income	\$ (9,903)	\$ (1,708)	\$ 1,624
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation	796	654	659
Amortization of intangibles	83	517	662
Provision for bad debt	139	17	69
Stock based compensation	43	51	79
Loss on disposal of fixed assets and impairment of intangible assets	51	256	133
Deferred tax benefit	(36)	(261)	(249)
Changes in operating assets and liabilities:			
Accounts receivable	(251)	(87)	(710)
Prepaid expenses and other assets	(391)	1,209	(617)
Restricted cash	202	561	(494)
Accounts payable and accrued liabilities	2,133	844	626
Deferred revenue	(498)	864	888
<b>Net cash (used in) provided by operating activities</b>	<b>(7,632)</b>	<b>2,917</b>	<b>2,670</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property and equipment	(920)	(677)	(647)
Proceeds from sale of property and equipment	56		
Acquisition of minority interest of eDiets Europe, net of cash acquired	179		
Effect of consolidation of previously unconsolidated subsidiary	2,749		
<b>Net cash provided by (used in) investing activities</b>	<b>2,064</b>	<b>(677)</b>	<b>(647)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Common stock registration costs	(561)	(23)	(54)
Proceeds from exercise of stock options and warrants	1,985	2,344	91
Issuance of common stock	7,048		
Retirement of common stock			(67)
Repayment of notes payable	(2)	(502)	(1,521)
Repayment of capital lease obligations	(122)	(140)	(170)
<b>Net cash provided by (used in) financing activities</b>	<b>8,348</b>	<b>1,679</b>	<b>(1,721)</b>
Effect of exchange rate changes on cash	(56)		
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>2,724</b>	<b>3,919</b>	<b>302</b>
Cash and cash equivalents, beginning of year	6,063	2,144	1,842
<b>Cash and cash equivalents, end of year</b>	<b>\$ 8,787</b>	<b>\$ 6,063</b>	<b>\$ 2,144</b>

**SUPPLEMENTAL CASH FLOW INFORMATION**

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Cash paid for:

Interest	\$ 20	\$ 132	\$ 33
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SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

Equipment acquired under capital leases	\$ 107	\$ 100	\$ 113
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*The accompanying notes are an integral part of these consolidated financial statements.*

F-5

**Table of Contents**

**EDIETS.COM, INC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2004**

**1. ORGANIZATION**

eDiets.com, Inc. (the Company) was incorporated in the State of Delaware on March 18, 1996 for the purpose of developing and marketing Internet-based diet and fitness programs. The Company markets its programs primarily through advertising and other promotional arrangements on the World Wide Web as well as offline advertising such as television. The Company's current operations are primarily concentrated in North America and Western Europe.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**PRINCIPLES OF CONSOLIDATION**

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

**CASH AND CASH EQUIVALENTS**

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents at December 31, 2004 include municipal securities with a fair value, which approximates cost, of \$550,000 and a maturity date of January 4, 2005. The Company considers these investments to be held-to-maturity securities and considers the interest rate risk to be low due to the short-term nature of the investments.

**PROPERTY AND EQUIPMENT**

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which is approximately three years for equipment and computer hardware and software, including internal use software, approximately seven years for furniture and fixtures and the shorter of the lease term or five years for leasehold improvements.

Expenditures for maintenance and repairs are charged to operations as incurred, while major renewals and betterments are capitalized. The assets and related depreciation are adjusted for asset retirements and disposals with the resulting gain or loss included in operations. Capitalized leases



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are initially recorded at the present value of the minimum payments at the inception of the lease.

AICPA Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed for or Obtained for Internal Use*, requires capitalization of certain costs incurred in connection with developing or obtaining internal use software. Costs capitalized pursuant to SOP 98-1 are included in property and equipment in the accompanying consolidated balance sheets.

The Company accounts for the development and maintenance of its website in accordance with Emerging Issues Task Force (EITF) 00-2, *Accounting for Web Site Development Costs*. Costs capitalized pursuant to EITF 00-2 are included in property and equipment in the accompanying consolidated balance sheets.

F-6

Table of Contents

## EDIETS.COM, INC

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## INTANGIBLES

Intangible assets related to the acquisition of eDiets Europe Limited (eDiets Europe) (see Note 5) are being amortized using the straight-line method over periods ranging from 20 months to 15 years with a weighted average life of approximately 12 years. The Company reviews each intangible asset type on an annual basis, or more frequently if events and circumstances warrant, to determine if any impairment exists.

Intangible assets related to the DietSmart merger in October 2001 were being amortized using the straight-line method over periods ranging from two to three years with a weighted average life of approximately 2.5 years. During the first quarter of 2004, the Company shut down the DietSmart website and commenced the process of encouraging the remaining DietSmart members to convert to the eDiets website. As a result of the shutting down of the website, and in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company recorded an impairment charge in its Consolidated Statement of Operations for the year ended December 31, 2004 of approximately \$54,000 related to the developed technology and trademarks and trade names intangibles.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, *Goodwill and Other Intangible Assets*. The Company adopted SFAS No. 142 as of January 1, 2002. SFAS No. 142 requires goodwill and other intangible assets to be subject to an assessment of impairment on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The assessment of impairment involves a two-step process prescribed in SFAS No. 142, whereby an initial assessment for potential impairment is performed, followed by a measurement of the amount of impairment, if any.

As of December 31, 2004, in the opinion of management, there had been no additional impairments. Intangible assets as recorded on the Company's balance sheets consist of the following (in thousands):

	December 31,	
	2004	2003
eDiets Europe acquisition intangibles:		
Technology licensing agreement	\$ 617	\$
Subscriber base	53	
Email address list	93	
Developed technology	49	
DietSmart merger intangibles:		
Email address list		838
Developed technology		254
Trademarks and trade names		293
	812	1,385
Less accumulated amortization	(54)	(1,305)

\$ 758      \$ 80

Estimated future annual amortization expense is as follows (in thousands):

Year ending December 31,	
2005	\$ 117
2006	92
2007	50
2008	48
2009	48

F-7

**Table of Contents**

**EDIETS.COM, INC**

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

**EQUITY INVESTMENT**

Through July 2004, the Company had a 60% interest in eDiets Europe, that was accounted for under the equity method of accounting as opposed to consolidating the results since the Company did not control the operation due to the substantive participating rights of the minority investor, including approval of significant operating decisions and approval of the annual operating budget. Since the Company had not invested any cash nor had the Company made any commitments to fund the entity, the Company did not record any losses for eDiets Europe through July 14, 2004. On July 15, 2004, the Company acquired the remaining 40% interest in eDiets Europe for a combination of cash and common stock valued at approximately \$2.3 million in total (see Note 5). As a result, eDiets Europe became a wholly-owned subsidiary of the Company and the accounts and results of operations since July 15, 2004 are included in the accompanying consolidated financial statements.

**REVENUE RECOGNITION**

The Company offers memberships to the proprietary content contained in its Web sites. Revenues from customer subscriptions represent the majority of the Company's business and are paid in advance mainly via credit cards. Subscriptions to the Company's nutrition, fitness, support and recipe plans are paid in advance and cash receipts are deferred and recognized as revenue on a straight-line basis over the period of the subscription.

In accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, the Company recognizes gross subscription revenues associated with licensed diet and fitness plans based on the relevant facts of the related license agreements, while the license fee incurred to the licensor is included in cost of revenues.

The Company collects customer subscription amounts in advance and maintains a reserve for refunds related to cancelable plans. Under cancelable plans, customers are entitled to cancel their memberships after an initial length of stay and receive a full refund for the unused portion of the membership.

Advertising revenue is recognized in the period the advertisement is displayed, provided that no significant Company obligation remains and collection is probable. Company obligations typically include guarantees of a minimum number of impressions or times that visitors to the Company's web site view an advertisement. Amounts received or billed for which impressions have not yet been delivered are reflected as deferred revenue. Opt-in email revenue is derived from the sale of email addresses of visitors to the Company's Web sites who have authorized the Company to allow third party solicitations. Revenues from the sale of email addresses are recognized when no significant Company obligation remains and collection is probable.

E-commerce revenue is currently derived from the sale of motivational audio tapes or compact disks, journals, pedometers, starter kits and other bundled products to consumers. Revenues from the sales of those products are recognized when the product is shipped.

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Commission revenue is derived from third party vendors on sales of products and services advertised on the Company's Web sites. Commission revenue is recognized when the third party vendor ships the product and collection is probable.

Royalty revenue is derived from the 15-year exclusive technology licensing agreement related to the Company's operations in the United Kingdom and Ireland and is being recognized on a straight-line basis over the term of the agreement.

F-8

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Revenue by type for the three years ended December 31, 2004 is as follows (in thousands):

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Membership	\$ 39,196	\$ 32,935	\$ 26,365
Advertising and sale of opt-in email addresses	4,005	3,390	1,946
Ecommerce	728	740	963
Commissions	1,209	1,267	354
Royalties	269		
	<u>\$ 45,407</u>	<u>\$ 38,332</u>	<u>\$ 29,628</u>

**COST OF REVENUE**

Cost of revenue consists primarily of credit card fees and revenue sharing or royalty costs related to exclusive license agreements with third party nutritional and fitness companies. Other costs include Internet access fees, compensation for nutritional and consulting professionals and product and fulfillment costs for ecommerce sales.

**STOCK-BASED COMPENSATION**

The Company applies the intrinsic value method provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for grants of options to Company directors, officers and employees under the Company's stock option plan. In September 2003, the Company granted an aggregate of 201,750 options to employees under the plan with an exercise price below the market value of the underlying common stock on the date of grant, with a total intrinsic value of approximately \$129,000. Consequently, compensation expense is being recognized on a straight-line basis over the 3-year vesting period of the options for the excess of the market value over the exercise price and totaled approximately \$43,000 and \$14,000 for the years ended December 31, 2004 and 2003, respectively. Additionally, during the year ended December 31, 2003 the Company recorded a \$37,000 expense in connection with the exercise of certain stock options that were exercised with shares of common stock rather than cash.

The following table illustrates the effect on net (loss) income and (loss) earnings per share as if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, in accounting for employee option grants under the plan.

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	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net (loss) income - as reported	\$ (9,903)	\$ (1,708)	\$ 1,624
Stock-based compensation expense included in reported net (loss) income	43	14	64
Pro forma compensation expense	(965)	(567)	(1,030)
	<u>          </u>	<u>          </u>	<u>          </u>
Pro forma net (loss) income	\$ (10,825)	\$ (2,261)	\$ 658
	<u>          </u>	<u>          </u>	<u>          </u>
Basic (loss) earnings per share			
As reported	\$ (0.49)	\$ (0.10)	\$ 0.10
	<u>          </u>	<u>          </u>	<u>          </u>
Pro forma	\$ (0.54)	\$ (0.14)	\$ 0.04
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted (loss) earnings per share			
As reported	\$ (0.49)	\$ (0.10)	\$ 0.09
	<u>          </u>	<u>          </u>	<u>          </u>
Pro forma	\$ (0.54)	\$ (0.14)	\$ 0.04
	<u>          </u>	<u>          </u>	<u>          </u>

F-9

**Table of Contents**

**EDIETS.COM, INC**

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

**LONG-LIVED ASSETS**

The Company accounts for long-lived assets pursuant to SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires impairment losses to be recorded on long-lived assets used in operations when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Management reviews long-lived assets and the related intangible assets for impairment whenever events or changes in circumstances indicate the assets may be impaired. An impairment loss is recorded when the net book value of the assets exceeds their fair value, as determined by projected discounted future cash flows.

**INCOME TAXES**

The Company accounts for income taxes under SFAS No. 109, *Accounting for Income Taxes*. Deferred income tax assets and liabilities are determined based upon differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recorded when it is more likely than not that some portion or all of a deferred tax asset will not be realized.

**ADVERTISING EXPENSE**

The Company expenses advertising costs as incurred. Advertising expenses incurred for the three years ended December 31, 2004 totaled approximately \$32,582,000, \$22,252,000 and \$12,887,000, respectively.

At December 31, 2004 and 2003, the Company had approximately \$349,000 and \$118,000, respectively, of prepaid advertising costs representing future online and offline advertising. Such costs are reflected as prepaid advertising costs in the accompanying consolidated balance sheets.

**BARTER TRANSACTIONS**

Advertising barter transactions are recorded at the estimated fair value of the advertising services received or given. Revenue from barter transactions is recognized when advertising is provided, and services received are charged to expense when used. The Company did not recognize any revenues or expenses related to barter transactions for the three years ended December 31, 2004. The Company did not enter into barter transactions for the years ended December 31, 2003 and 2002. For the year ended December 31, 2004, the Company entered into barter transactions that did not result in revenue recognition, because the fair value was not determinable, for approximately 27 million impressions on its website.



**(LOSS) EARNINGS PER COMMON SHARE**

Basic (loss) earnings per common share is computed using the weighted average number of common shares outstanding during the period. Diluted (loss) earnings per share is computed using the weighted average number of common and dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of the incremental common shares issuable upon exercise of stock options and warrants (using the treasury stock method), which were not included in diluted loss per share for the years ended December 31, 2004 and 2003 as they would have been antidilutive.

F-10

**Table of Contents**

**EDIETS.COM, INC**

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

**CONCENTRATIONS OF CREDIT RISK**

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, including investments, accounts receivable from credit card transaction processing companies, and receivables from third parties related to advertising and commissions, ecommerce, and opt-in email revenue. The Company has policies that limit its investments as to maturity, liquidity, credit quality, concentration and diversification of issuers and types of investments. The credit risk associated with cash and cash equivalents and credit card receivables is considered low due to the credit quality of the financial institution and issuers. The Company performs credit evaluations of the third parties from which advertising, ecommerce, and opt-in email revenue is earned and generally does not require collateral. The Company maintains allowances for potential credit losses for such events.

**FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amounts of the Company's accounts receivable, accounts payable and accrued liabilities approximate their fair market value due to their short-term nature.

**USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**RECLASSIFICATIONS**

Certain reclassifications of the prior years' consolidated financial statements have been made to conform to the current year's presentation.

**FOREIGN CURRENCY TRANSLATION**

Foreign currency assets and liabilities are translated into United States dollars using the exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average rates prevailing during the periods reported. The effects of exchange rate fluctuations on the translation of assets and liabilities are reported as other comprehensive income, which is a separate component of stockholders' equity.

### 3. ACCOUNTS RECEIVABLE

Accounts receivable are shown in the accompanying consolidated balance sheet net of an allowance for doubtful accounts of approximately \$98,000 and \$62,000 at December 31, 2004 and 2003, respectively. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and customers' credit worthiness, as determined by the Company's review of their current credit information. The Company continuously monitors collections and payments from its customers and maintains an allowance for estimated credit losses based upon its historical experience and specific customer collection issues that the Company has identified. Accounts receivable are evaluated and written-off against the allowance if they are determined to be uncollectible.

F-11

Table of Contents

## EDIETS.COM, INC

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**4. PROPERTY AND EQUIPMENT**

Property and equipment, net consists of the following (in thousands):

	December 31,	
	2004	2003
Office and computer equipment	\$ 2,040	\$ 1,559
Software	2,040	1,627
Furniture and fixtures	138	116
Leasehold improvements	73	69
	<u>4,291</u>	<u>3,371</u>
Less accumulated depreciation and amortization	(2,974)	(2,251)
	<u>\$ 1,317</u>	<u>\$ 1,120</u>

Software includes approximately \$1,676,000 and \$1,324,000 of costs associated with internal-use software projects and Web site development that have been capitalized pursuant to SOP 98-1 and EITF 00-2 as of December 31, 2004 and 2003, respectively. Included in property and equipment is equipment under capital leases of approximately \$539,000 and \$598,000 as of December 31, 2004 and 2003, respectively, less accumulated amortization of approximately \$420,000 and \$460,000, respectively. Depreciation expense includes amortization of equipment under capital leases.

**5. ACQUISITION OF EDIETS EUROPE**

On July 15, 2004, eDiets BVI, Inc., a wholly-owned subsidiary of eDiets.com, Inc., acquired the 40% of eDiets Europe not already owned for approximately \$1,529,000 and 255,605 shares of common stock of eDiets.com, Inc. valued at approximately \$726,000. As a result, eDiets Europe became a wholly-owned subsidiary of the Company.

The 40% minority interest of eDiets Europe was acquired from Ciaran McCourt, an eDiets board member. In connection with the buyout of the minority interest owned by the related party, the Company utilized a third party advisor to assist in the determination of the purchase price to be paid by the Company. Accordingly, the Company believes such buyout of the minority interest was completed on an arm's length basis.

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The primary reason for the acquisition of eDiets Europe was to be able to accelerate revenue growth and cash flows by consolidating the Company's operations in the US and Europe. In addition, through the acquisition of eDiets Europe, the Company believes it will benefit by working with Tesco.com, a wholly-owned subsidiary of Tesco plc, under an exclusive 15-year license agreement involving eDiets' online diet service in the United Kingdom and Ireland and having Tesco offer this service to a much wider audience.

The acquisition was accounted for under the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations*. The results of operations of eDiets Europe have been included in the Company's financial statements for periods subsequent to July 15, 2004. The Company allocated the cost of the acquisition to the assets acquired and the liabilities assumed based on their estimated fair values. The excess of the cost over the fair value of net assets acquired of approximately \$1,822,000 has been reflected as goodwill and is not expected to be deductible for income tax purposes.

F-12

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

A summary of the purchase price for the acquisition is as follows (in thousands):

Cash	\$ 1,529
Common stock	726
Direct acquisition costs	120
	<hr/>
Total purchase price	\$ 2,375
	<hr/>

The purchase price was allocated as follows (in thousands):

Current assets acquired (including cash of \$1,921)	\$ 1,954
Property and equipment	7
Intangibles	737
Liabilities assumed	(2,053)
Deferred tax liability	(92)
Goodwill	1,822
	<hr/>
Total	\$ 2,375
	<hr/>

Intangibles acquired and their weighted average lives are as follows (in thousands):

		Asset
		Life
		<hr/>
Technology licensing agreement	\$ 560	15 Years
Subscriber base	48	1.67 Years
Email address list	84	2.5 Years
Developed technology	45	7 Years
	<hr/>	
	\$ 737	
	<hr/>	

Liabilities assumed include an estimated liability of approximately \$293,000 related to a dispute with the Irish tax authorities concerning the amount of value added tax (VAT) due for diet programs previously sold. The outcome of this dispute is uncertain, but the Company does not believe that the impact on its financial condition or results of operations will be material.

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The following presents the unaudited pro forma results of the Company for the years ended December 31, 2004 and 2003 as if the acquisition of the 40% minority interest of eDiets Europe had occurred at the beginning of each of the respective periods (in thousands, except per share amounts). Pro forma results are not necessarily indicative of actual results.

	<b>2004</b>	<b>2003</b>
	<b>(unaudited)</b>	
Revenues	\$ 47,866	\$ 40,892
Net loss	\$ (10,050)	\$ (1,965)
Loss per common share		
Basic and diluted	\$ (0.50)	\$ (0.12)
Weighted average common shares outstanding		
Basic and diluted	20,228	16,931

F-13

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****6. ACCRUED LIABILITIES**

Accrued liabilities consist of the following (in thousands):

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
Advertising	\$ 1,233	\$ 604
Accrued compensation and employee benefits	570	416
Professional fees	37	208
Irish taxes payable	1,207	
Other	684	356
	<b>\$ 3,731</b>	<b>\$ 1,584</b>

**7. RESERVE FOR REFUNDS AND UNEARNED SUBSCRIPTION REVENUE**

The Company collects customer subscription fees ranging from one to twelve months in advance. At the time of sale the Company establishes a reserve for refunds related to cancelable subscription plans and defers the remaining subscription fees, which are recognized as revenue over the period of membership. The reserve for refunds and unearned subscription revenue related to subscription fees, which is reflected as deferred revenue in the accompanying consolidated balance sheets, consists of the following at December 31, 2004 and 2003 (in thousands):

	<b>2004</b>	<b>2003</b>
Reserve for Refunds	\$ 272	\$ 344
Unearned Subscription Revenue	\$ 3,291	\$ 3,916

For the years ended December 31, 2004 and 2003, refunds to customers who paid in their subscription fees advance totaled approximately \$9,629,000 and \$7,119,000, respectively.

**8. EMPLOYEE BENEFIT PLAN**



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The Company maintains a defined contribution benefit plan (401(k) salary deferral program) covering substantially all employees. Employees may elect to contribute to the plan amounts not to exceed a specified percentage of annual compensation, subject to the current limit imposed by Internal Revenue Service guidelines. The Company, at its discretion, may match the participant's contributions at a specified percentage, limited by a stated maximum amount. An unrelated investment company administers the assets of the plan. The total employer contributions charged to expense for the three years ended December 31, 2004 were approximately \$73,000, \$60,000 and \$50,000, respectively.

### 9. STOCKHOLDERS' EQUITY

#### COMMON STOCK

In April 2004, the Company completed a private placement of 1.6 million shares of common stock at a price of \$4.40 per share. Net proceeds to the Company were approximately \$6.5 million. The Company is using the net proceeds from the private placement for working capital and general corporate purposes.

In connection with the acquisition of eDiets Europe as discussed in Note 5, a total of 255,605 shares of the Company's common stock were issued.

At December 31, 2004, 2,387,044 common shares were reserved for future issuance related to outstanding stock options.

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**Table of Contents**

**EDIETS.COM, INC**

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

**STOCK OPTIONS**

In May 1996, the Company adopted the Startup Equity Program (the Startup Program), pursuant to which the Company granted non-qualified stock options to certain employees and consultants during the company's start-up phase. Options granted under the Start-up Program are exercisable over a five or ten-year period from the date of grant at an exercise price of \$0.01 per share and are fully vested. In addition, through the first half of 1999, the Company granted additional stock options to certain employees and non-employees, which were issuable at the discretion of the Company's Board of Directors. All such additional options are exercisable over a five or ten-year period from the date of grant at an exercise price of \$0.01 per share and are fully vested. A total of 917,716 options were granted under these programs, of which 203,657 options remained outstanding as of December 31, 2004.

In November 1999, the Company adopted the eDiets.com, Inc. Stock Option Plan (the Plan) (as amended and restated effective April 1, 2002). The Plan, as amended, provides for the grant of incentive stock options and non-qualified stock options to purchase up to 5,000,000 shares of the Company's common stock to employees, directors and consultants to the Company. Options granted to employees under the Plan generally vest ratably over a two- or three-year period and expire five or ten years from the date of grant. Such options generally have an exercise price equal to the fair market value of the underlying common stock at the grant date and are fully exercisable on the date of grant for a period of up to five to ten years. As of December 31, 2004, 2,183,387 options are outstanding under the Plan.

In November 2004, the Company adopted the eDiets.com, Inc. 2004 Equity Incentive Plan (the Incentive Plan). The Incentive Plan provides for the grant of incentive stock options or ISOs, non-qualified stock options or NSOs, stock appreciation rights or SARs, restricted stock, deferred stock and unrestricted stock. The Plan is administered by the Governance Committee of the Board of Directors (the Committee). A maximum of 1,500,000 shares of Common Stock may be delivered in satisfaction of awards made under the Incentive Plan. The maximum number of shares of Common Stock that may be issued pursuant to the exercise of ISOs and NSOs is 800,000 each. The maximum benefit that would be paid to any person under other awards in any calendar year is 450,000 shares. The term of any option granted under the Incentive Plan may not exceed ten years. SARs may be granted either in tandem with or independent of stock options. The Incentive Plan provides for awards of nontransferable shares of Common Stock subject to repurchase or forfeiture. The minimum period that restrictions must remain in place is three years unless the restricted Common Stock is also subject to performance conditions, in which case the minimum period is one year. The Incentive Plan prohibits the Committee from waiving these restriction periods. The Incentive Plan also provides for awards of unrestricted stock, but no more than 90,000 shares in the aggregate may be granted at less than fair market value. The Incentive Plan also provides for deferred grants entitling the recipient to receive Common Stock upon satisfactions or conditions determined by the Committee in its discretion. As of December 31, 2004, there were no options or stock outstanding under the Incentive Plan.

Certain options granted to employees were at an exercise price lower than the fair market value of the underlying common stock at the grant date. Compensation expense is being recognized on a straight-line basis for the excess of the fair market value over the exercise price and totaled approximately \$43,000, \$14,000 and \$2,000 for the three years ended December 31, 2004, respectively.

For the three years ended December 31, 2004, a total of 953,000, 1,458,000 and 310,000 stock options were exercised by the holders, resulting in proceeds of approximately \$1,724,000, \$1,588,000 and \$91,000 to the Company, respectively.



**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

A summary of the activity relating to the Company's stock options for the years ended December 31, 2004, 2003 and 2002 is presented below (shares in thousands):

	2004		2003		2002	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,964	\$ 2.00	3,845	\$ 1.44	4,098	\$ 1.23
Granted	568	4.66	828	2.94	1,069	1.85
Exercised	(953)	1.81	(1,458)	1.17	(310)	0.29
Forfeited	(192)	4.05	(251)	1.35	(1,012)	1.35
Outstanding at end of year	2,387	2.54	2,964	2.00	3,845	1.44
Options exercisable at end of year	1,660	\$ 1.93	2,133	\$ 1.65	3,105	\$ 1.35
Weighted average exercise price of options granted during the year:						
Issued at market price		\$ 4.66		\$ 2.96		\$ 1.63
Issued above market price		n/a		n/a		\$ 2.45
Issued below market price		n/a		\$ 2.86		n/a
Weighted average fair value of options granted during the year:						
Issued at market price		\$ 2.28		\$ 1.76		\$ 0.83
Issued above market price		n/a		n/a		\$ 1.17
Issued below market price		n/a		\$ 2.03		n/a

The following table summarizes information about stock options outstanding at December 31, 2004 (shares in thousands):

Options Outstanding	Options Exercisable
---------------------	---------------------

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<b>Range Of Exercise Prices</b>	<b>Outstanding At December 31, 2004</b>	<b>Weighted Average Remaining Contractual Life (In Years)</b>	<b>Weighted Average Exercise Price</b>	<b>Exercisable At December 31, 2004</b>	<b>Weighted Average Exercise Price</b>
\$0.01 to 0.03	204	1.7	\$ 0.01	204	\$ 0.01
0.27 to 1.50	413	1.8	1.18	410	1.18
1.51 to 2.00	481	1.8	1.77	466	1.78
2.01 to 3.00	636	4.8	2.68	343	2.57
3.01 to 4.01	487	5.4	3.66	202	3.73
6.85 to 7.60	166	3.9	7.49	35	7.44
	<b>2,387</b>	<b>3.5</b>	<b>2.54</b>	<b>1,660</b>	<b>1.93</b>

F-16

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Pro forma information is required by SFAS No. 123, as amended by SFAS No. 148, and has been determined as if the Company had accounted for its stock-based compensation plans under the fair value method. The fair value of each option grant was estimated at the date of grant using the Black-Scholes option-pricing model for 2004, 2003 and 2002 grants with the following weighted average assumptions: expected volatility factor of 70% for 2004 and 60% for 2003 and 2002; risk free interest rates of 2.8% for 2004, 3.0% for 2003 and 3.9% for 2002; dividend yield of 0%; and expected life of 3.0 years for 2004, 5.0 years for 2003 and 4.0 years for 2002. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Because the determination of the fair value of the Company's options is based on the assumptions described above, and because additional option grants are expected to be made in future periods, this pro forma information is not likely to be representative of the pro forma effects on reported net income or loss for future years. Refer to Note 2 for the pro forma effect of fair value reporting on the results of operations and (loss) earnings per share for the three years ended December 31, 2004.

**10. COMMITMENTS, CONTINGENCIES AND RELATED PARTY TRANSACTIONS**

The Company leases certain office space and equipment under various operating leases. In addition to rent, the leases require the Company to pay for taxes, insurance maintenance and other operating expenses. Certain of the leases contain stated escalation clauses while others contain renewal options. The Company recognizes rent expense on a straight-line basis over the term of the lease, excluding renewal periods, unless renewal of the lease is reasonably assured. Commitments for minimum rentals under non-cancelable leases at the end of 2004 are as follows (in thousands):

	<b>Capital Leases</b>	<b>Operating Leases</b>
2005	\$ 106	\$ 182
2006	38	124
<b>Total minimum lease payments</b>	<b>144</b>	<b>\$ 306</b>
<b>Less amount representing interest</b>	<b>(11)</b>	
<b>Present value of minimum lease payments</b>	<b>\$ 133</b>	

Rental expense under operating leases was approximately \$240,000, \$218,000 and \$282,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

In July 2001, the Company entered into a lease agreement for office space in Deerfield Beach, Florida. In accordance with this lease, the landlord retains a lien and security interest in all property within the building, including all furniture and equipment, to secure payments for all rents arising under the lease.

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In the ordinary course of business, the Company and/or its subsidiaries may be parties to legal proceedings and regulatory inquiries, the outcome of which, either singly or in the aggregate, is not expected to have a material adverse effect on our financial condition or results of operations.

The Company has non-cancelable online advertising commitments with major Internet portals totaling approximately \$13,165,000, and non-cancelable television advertising commitments of approximately \$4,324,000 in 2005.

F-17

Table of Contents

## EDIETS.COM, INC

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 11. INCOME TAXES

The components of the income tax benefit for the years ended December 31, 2004, 2003 and 2002 are as follows (in thousands):

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Current tax (expense) benefit US	\$ (3)	\$ (3)	\$ 2
Deferred tax benefit US	30	261	249
Deferred tax benefit Foreign	6		
	<u>        </u>	<u>        </u>	<u>        </u>
Total	\$ 33	\$ 258	\$ 251
	<u>        </u>	<u>        </u>	<u>        </u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes as of December 31, 2004 and 2003 are as follows (in thousands):

	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 6,570	\$ 3,033
Deferred compensation	27	133
Allowance for doubtful accounts and reserve for refunds	140	151
Other	53	9
	<u>        </u>	<u>        </u>
	6,790	3,326
Valuation allowance	(6,689)	(3,302)
	<u>        </u>	<u>        </u>
Total deferred tax assets	101	24
Deferred tax liabilities:		
Depreciation and amortization	(101)	(24)
Identifiable intangibles	(95)	(30)
	<u>        </u>	<u>        </u>
Total deferred tax liabilities	(196)	(54)
	<u>        </u>	<u>        </u>
Net deferred income tax liability	\$ (95)	\$ (30)
	<u>        </u>	<u>        </u>



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SFAS No. 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all evidence, both positive and negative, management has determined that an approximately \$6,689,000 and \$3,302,000 valuation allowance at December 31, 2004 and 2003, respectively, is necessary to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in the valuation allowance for the years ended December 31, 2004, 2003 and 2002 was an increase (decrease) of approximately \$3,387,000, \$691,000 and \$(1,108,000), respectively.

At December 31, 2004, the Company had approximately \$26,562,000 in net operating loss carryforwards for U.S. federal income tax purposes that expire in various amounts through 2021. Approximately \$9,123,000 of the net operating loss carryforwards relate to stock option deductions that will be recognized through additional paid-in-capital when the net operating losses are utilized. During 2002, the Company completed a study and determined that a change in control, as defined under Section 382 of the Internal Revenue Code, had occurred and, as a result, the Company's net operating loss carryforwards existing at the time of the change in control are limited to approximately \$1,664,000 on an annual basis and could expire unused.

F-18

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The reconciliation of income tax computed at the U.S federal statutory rate to income tax expense (benefit) for the years ended December 31, 2004, 2003 and 2002 is as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Tax at U.S. statutory rate	(34.00)%	(34.00)%	34.00%
State taxes, net of federal benefit	(3.61)	(3.55)	3.75
Non-deductible items	0.16	0.78	1.29
Changes in valuation allowance	33.49	23.49	(57.05)
Other	3.63		(0.27)
	<u>(0.33)%</u>	<u>(13.28)%</u>	<u>(18.28)%</u>

**12. SEGMENT INFORMATION**

SFAS No. 131 ( SFAS 131 ), *Disclosures about Segments of an Enterprise and Related Information*, designates the internal reporting that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments.

The Company operates in a single market consisting of the sale of services, information and products related to nutrition, fitness and motivation. Commencing with the acquisition of eDiets Europe in July 2004, the Company's revenues are derived from two geographical regions: United States and Europe. These two geographic regions constitute the Company's two reportable segments.

The Company does not engage in inter-company revenue transfers between segments. The Company's management evaluates performance based primarily on revenues in the geographic regions in which the Company operates. Accounting policies of the segments are the same as the Company's consolidated accounting policies.

Revenues and segment loss of the Company's two reportable segments for the year ended December 31, 2004 are as follows (in thousands):

	<u>2004</u>
Revenues:	
United States	\$ 44,892
Europe	515

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Consolidated revenues	\$ 45,407
Segment loss:	
United States	\$ 9,939
Europe	112
Consolidated loss from operations	\$ 10,051

F-19

**Table of Contents****EDIETS.COM, INC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Identifiable assets of the Company's two reportable segments at December 31, 2004 are shown below.

Long-lived assets consist of property and equipment, net:

	<u>2004</u>
Identifiable assets:	
United States	\$ 14,513
Europe	5,627
	<u>          </u>
Total identifiable assets	\$ 20,140
	<u>          </u>
Long-lived assets, net:	
United States	\$ 1,310
Europe	7
	<u>          </u>
Total long-lived assets, net	\$ 1,317
	<u>          </u>

**13. (LOSS) EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted (loss) earnings per common share for the three years ended December 31, 2004 (in thousands, except per share information):

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<i>Basic (loss) earnings per common share:</i>			
Net (loss) income	\$ (9,903)	\$ (1,708)	\$ 1,624
	<u>          </u>	<u>          </u>	<u>          </u>
Weighted average common shares outstanding	20,091	16,675	15,730
	<u>          </u>	<u>          </u>	<u>          </u>
Basic (loss) earnings per common share	\$ (0.49)	\$ (0.10)	\$ 0.10
	<u>          </u>	<u>          </u>	<u>          </u>
<i>Diluted (loss) earnings per common share:</i>			
Net (loss) income	\$ (9,903)	\$ (1,708)	\$ 1,624
	<u>          </u>	<u>          </u>	<u>          </u>
Weighted average common shares outstanding	20,091	16,675	15,730
Effect of dilutive potential common shares:			
Stock options and warrants			1,402

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Adjusted weighted average shares and assumed conversions	<u>20,091</u>	<u>16,675</u>	<u>17,132</u>
Diluted (loss) earnings per common share	<u>\$ (0.49)</u>	<u>\$ (0.10)</u>	<u>\$ 0.09</u>

F-20

**Table of Contents**

**EDIETS.COM, INC**

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

**14. RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R, *Share-Based Payment*. SFAS No. 123R requires companies to expense the value of employee stock option and similar awards. SFAS No. 123R is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. As of the effective date, the Company will be required to expense all awards granted, modified, cancelled or repurchased as well as the portion of prior awards for which the requisite service has not been rendered, based on the grant-date fair value of those awards as calculated for pro forma disclosures under SFAS No.123. SFAS No.123R permits public companies to adopt its requirements using one of two methods: A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. A prospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123R for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The adoption of SFAS No. 123R's fair value method will have an impact on the Company's results of operations. The Company is currently in the process of determining the effects on its financial position, results of operations and cash flows that will result from the adoption of SFAS No. 123R under the modified prospective method.

**Table of Contents****SUPPLEMENTAL FINANCIAL INFORMATION****QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Total Year</u>
<b>2004</b>					
Net Revenues	\$ 11,076	\$ 11,385	\$ 11,810	\$ 11,136	\$ 45,407
Loss from operations	(3,050)	(5,496)	(1,399)	(106)	(10,051)
Net loss	(3,013)	(5,469)	(1,363)	(58)	(9,903)
Basic loss per common share	(0.16)	(0.27)	(0.07)	(0.00)	(0.49)
Diluted loss per common share	(0.16)	(0.27)	(0.07)	(0.00)	(0.49)
<b>2003</b>					
Net Revenues	\$ 7,331	\$ 9,049	\$ 11,120	\$ 10,832	\$ 38,332
(Loss) Income from operations	(2,052)	(1,800)	775	1,098	(1,979)
Net (loss) income	(2,003)	(1,740)	919	1,116	(1,708)
Basic (loss) earnings per common share	(0.13)	(0.11)	0.05	0.06	(0.10)
Diluted (loss) earnings per common share	(0.13)	(0.11)	0.05	0.06	(0.10)

The sum of the quarterly (loss) earnings per common share amounts do not add to the annual loss per share amount due to the weighting of common and common equivalent shares outstanding during each of the respective periods.

**Table of Contents****EDIETS.COM, INC****SCHEDULE II****VALUATION AND QUALIFYING ACCOUNTS**

<u>DESCRIPTION</u>	<u>BALANCE AT BEGINNING OF PERIOD</u>	<u>CHARGED TO COSTS AND EXPENSES</u>	<u>CHARGED TO OTHER ACCOUNTS</u>	<u>DEDUCTIONS</u>	<u>BALANCE AT END OF PERIOD</u>
(in thousands)					
<b>Year ended December 31, 2004</b>					
Allowance for doubtful accounts	\$ 62	\$ 139	\$	\$ (103)(1)	\$ 98
Returns reserve	344		9,557(2)	(9,629)	272
Valuation allowance for deferred tax assets	3,302	3,387			6,689
<b>Year ended December 31, 2003</b>					
Allowance for doubtful accounts	\$ 66	\$ 17	\$	\$ (21)(1)	\$ 62
Returns reserve	26		7,437(2)	(7,119)	344
Valuation allowance for deferred tax assets	2,611	691			3,302
<b>Year ended December 31, 2002</b>					
Allowance for doubtful accounts	\$ 17	\$ 69	\$	\$ (20)(1)	\$ 66
Returns reserve	26		761(2)	(761)	26
Valuation allowance for deferred tax assets	3,719			(1,108)	2,611

(1) Uncollectible accounts written off, net of recoveries.

(2) Returns reserve recorded as an offset to revenue.



**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
21.1	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, Section 906 of the Sarbanes-Oxley Act of 2002.