EDIETS COM INC
Form 10-K
March 30, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

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

Commission File Number: 000 - 30559

eDiets.com, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**56-0952883**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1000 Corporate Drive, Suite 600

Fort Lauderdale, FL 33334

(Address of principal executive offices) (zip code)

(954) 360-9022

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, Par Value $0.001 Per Share	OTC Bulletin Board

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ¨.

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

¨ Large accelerated filer ¨ Accelerated filer

¨ Non-accelerated filer (Do not check if a smaller reporting company) x Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

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 close price for such stock on that date, was approximately $6.9 million.

As of March 16, 2012, there were 14,310,534 shares of the registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2011. Portions of such proxy statement are incorporated by reference into Part III of this Annual Report on Form 10-K.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The information contained in this Annual Report on Form 10-K and the documents that are incorporated by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements concern expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. Specifically, this Annual Report on Form 10-K and the documents incorporated by reference contain forward-looking statements regarding:

- our expectation that we will seek additional financial support and that that management will continue to evaluate various possibilities, including through a private placement or public offering of our common stock or securities convertible into our common stock, selling one or more lines of business, or all or a portion of the Company s assets, entering into a business combination, reducing or eliminating operations, liquidating assets, or seeking relief through a filing under the U.S. Bankruptcy Code;
- our belief regarding market demand for our products and our competitive position in our industry;
- our expectation regarding the efficiency and effectiveness of our advertising;
- our expectation that our total gross margins will continue to improve in the future as our continued efforts to improve meal delivery margin are realized;
- our expectation that revenue streams from meal delivery will continue to be the largest share of total revenues;
- our belief that we can rapidly secure alternate technology infrastructure vendors if we experience an interruption in website or call center service;
- our expectations regarding implementing programs designed to enhance the privacy protection of our visitors to our website;
- our expectation that we will conduct our operations in compliance with applicable regulatory requirements;
- our expectation regarding the effect of any legal proceedings or legal inquiries on our financial condition or results of operations; and
- our estimates regarding certain accounting and tax matters, including the adoption of certain accounting pronouncements.

These forward-looking statements reflect our current views about future events and are subject to risks, uncertainties and assumptions. We wish to caution readers that certain important factors may have affected and could in the future affect our actual results and could cause actual results to differ significantly from those expressed in any forward-looking statement. The most important factors that could prevent us from achieving our goals, and cause the assumptions underlying forward-looking statements and the actual results to differ materially from those expressed in or implied by those forward-looking statements include, but are not limited to, the following:

- our ability to raise additional capital;

our ability to maintain compliance with applicable regulatory requirements;

our ability to attract and retain customers at an acceptable cost;

the effectiveness of our marketing and advertising programs;

our inability to recruit and retain key executive officers;

our ability to accurately assess market demand for our products;

our ability to continue to develop innovative new services and products and enhance our existing services and products, or the failure of our services and products to continue to appeal to the market;

our ability to improve our meal delivery margin and its effect on total gross margins;

our ability to rapidly secure alternate technology infrastructure vendors if we experience website or call center service interruption;

competition from other weight management industry participants or the development of more effective or more favorably perceived weight management methods;

the impact of our debt service obligations;

our ability to successfully implement programs designed to enhance the privacy protection of our visitors to our website;

our ability to sufficiently increase our revenues and maintain expenses and cash capital expenditures at appropriate levels;

the state of the credit markets and capital markets, including the level of volatility, illiquidity and interest rates; and

our ability to successfully estimate certain accounting and tax matters, including the effect on our Company of adopting certain accounting pronouncements.

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ITEM 1. BUSINESS
GENERAL

Products and Services

eDiets.com, Inc. (eDiets , the Company or we) leverages the power of technology to bring weight loss solutions to both consumers and businesses. We generate revenue in four ways:

- We offer a nationwide weight-loss oriented meal delivery service.
- We sell digital weight-loss programs.
- We derive licensing revenues for the use of our intellectual property and development revenues related to the planning, design and development of private-label nutrition websites.
- We sell advertising throughout our content assets, which are primarily our diet, fitness and healthy lifestyle-oriented websites.

Subscription Business (includes our digital subscription-based plans and our meal delivery plans)

We have been offering digital subscription-based plans in the United States since 1998, when we launched our first diet plan. Our digital diet plans are personalized according to an individual s weight goals, food and cooking preferences and include the related shopping lists and recipes. eDiets offers a variety of approximately twenty different diet plans, some of which we have developed and some of which we have licensed from third parties under exclusive arrangements. We also offer a subscription-based nationwide weight-loss oriented meal delivery service.

Subscribers to our digital diet and meal delivery plans are acquired through our own advertising or through co-marketing arrangements with third parties. In addition to a digital diet or meal delivery product, they receive access to support offerings including interactive online information, communities and education as well as telephone and online support. eDiets offers message boards on various topics of interest to our subscribers, online meetings presented by registered dietitians and the resources of approximately 45 customer service representatives and nutritionists.

Digital subscription programs ranging from four weeks to 52 weeks are billed in advance in varying increments of time. Substantially all of our digital subscribers purchase programs via credit/debit cards, with renewals billed automatically, until cancellation. During 2011 we recorded approximately $2.6 million in digital plans revenue, or approximately 11.6% of total revenues for 2011.

Meal delivery subscribers purchase a full week or five days of prepared breakfasts, lunches, and dinners, supplemented by snacks that are generally shipped to arrive within two to three days. During 2011 we recorded approximately $17.7 million in meal delivery revenue, or approximately 80.0% of total revenues for 2011.

License Business (includes business-to-business and royalty revenue)

Our eDiets Corporate Services subsidiary is actively engaged in providing private label online nutrition, fitness and wellness programs to companies mainly in the health insurance, pharmaceutical and food industries. During 2011 we recorded approximately $1.1 million in business-to-business revenue, or approximately 4.9% of total revenues for 2011.

We also recognized approximately $0.6 million in royalty revenue in 2011 as a result of having licensed to Tesco plc (Tesco) the exclusive rights to use eDiets brand and diet plan technology in the UK and Ireland. Effective July 31, 2009, we terminated this exclusive licensing agreement with Tesco. The termination agreement provides Tesco with certain continuing rights in the Company technology used by or incorporated into Tesco s diet website prior to termination, including a three-year non-exclusive right to use such technology and, thereafter, an assignment of certain intellectual property rights relating to such technology.

Content Business (includes advertising and ecommerce revenue)

Our advertising sales revenues from third-party banner impressions on our website were approximately $0.2 million, or approximately 1.0% of total revenues for 2011, and are derived from our flagship website, www.eDiets.com. The site includes free content developed primarily by our in-house editorial staff.

Our Industry

The weight loss industry in the U.S. is large and continues to grow. According to Marketdata Enterprises, Inc. in a 2011 report, our particular segment, the Online Dieting Market, was estimated to grow from approximately $990.0 million in 2010 to $1.2 billion in 2014.

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We believe the growing population of overweight and obese people who are motivated by both an increasing awareness of the health benefits of weight loss and the desire to improve their lives is driving the growth of weight-loss solutions. We believe our comprehensive and integrated weight-loss offerings, which include our fresh-prepared meal delivery service, personalized online subscription-based plans and licensing related to private-label websites uniquely positions us in serving both consumers and businesses.

Marketing

Our total advertising media spending in 2011 was approximately $6.3 million, or approximately 28.6% of revenues. We currently pay to advertise our services through cable television placements, online paid and natural search programs, Web affiliate programs, third party online banners, and print advertising campaigns. In addition, we advertise on our websites and in our email newsletters. Over the last few years our cost to acquire subscribers through banner advertisements on the major online portals has risen as a result of rapidly rising online advertising rates. We have responded by shifting an increasing percentage of our advertising budget to television, paid search programs and co-marketing partnerships.

Competition

We face significant competition. In the online subscription diet business our most significant competitor is www.weightwatchers.com, which is owned by Weight Watchers® International. We also compete with privately-held Waterfront Media, Inc., which operates a variety of diet- and self-help-oriented websites including www.southbeachdiet.com, and with the WebMD® Weight Loss Center operated by WebMD, Inc. In the meal delivery business we compete with Nutrisystem, Inc. and Jenny Craig, Inc. as well as others. In the business-to-business licensing of digital diet, fitness and healthy lifestyle content, tools and services we compete with Miavita, which is owned by Matria Healthcare, Inc., Nutrihand, Genesant, and with several private companies. Many of our competitors in the weight loss industry, including NutriSystem, Inc. and Jenny Craig, Inc., are significantly larger and have greater financial resources than we do and may be able to devote greater resources for the development and promotion of their services and products. We mainly compete in the areas of program efficacy, price, taste, customer service and brand recognition.

Dependence on Third Parties

We derive significant portions of our business from relationships with both third party websites and third party licensors. 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 website 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 tier 1 collocation facilities in Chicago, Illinois and Lithia Springs, Georgia. 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 2011, our site was operating 99% 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.

Approximately 80% of our revenue comes from our meal delivery program, from which we currently depend on one third party meal delivery vendor for the manufacture and fulfillment of our prepared meals. If we are unable to obtain sufficient quantity, quality and variety of food and fulfillment of customer orders in a timely and low-cost manner from this manufacturer, we will be unable to adequately fulfill our customers orders which would adversely affect our operating results and damage the value of our brand. Our orders are currently shipped by one third-party, United Parcel Service, Inc.

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INTELLECTUAL PROPERTY, PROPRIETARY RIGHTS AND DOMAIN NAMES

Our success depends on the goodwill associated with our trademarks and other proprietary intellectual property rights.

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 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 are an increasing number of laws and regulations being promulgated by the United States government, 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 website 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 websites, we are liable in tort, contract or intellectual property, for the wrongful actions of third party website 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.

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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 websites, 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 website; 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 renewed its focus on claims made in weight-loss advertisements, announcing, for example, new guidelines effective December 2009 concerning the use of endorsements and testimonials in advertising. 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, we generate advertising revenue from third-party banner impressions on our website. These advertisements can be weight-loss related. Any regulations or enforcement actions that adversely affect the companies which advertise on our website 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

We rely to varying degrees 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 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.

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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/AbouteDiets.jsp. 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 website.

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

We currently employ approximately 63 employees of which 59 are full time employees.

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 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.

Much of 1996 and 1997 were spent in developing a 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 sold our first online diet program in 1998 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 then Chief Executive Officer, David Humble, 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 2003, we implemented a 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 all at one web location.

In 2006, we started to diversify our revenue streams by entering the business-to-business nutrition space with the acquisition of Nutrio.com, Inc. (Nutrio) and also with our launch of a nationwide diet meal delivery service.

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

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Executive Officers of Registrant

Set forth below is certain information relating to our current executive officers.

Thomas Connerty	48	President and Chief Executive Officer
Kevin A. Richardson II	43	Chairman

Mr. Connerty joined the Board in April 2011 and was appointed President and Chief Executive Officer of the Company in February 2012. He has over 25 years of expertise in direct response marketing with leading consumer branded companies. Mr. Connerty formerly held a number of senior positions with Nutrisystem, Inc., a commercial provider of weight loss products and services, including Chief Marketing Officer from November 2004 to May 2008, Executive Vice President from April 2005 to May 2008 and Executive Vice President of Program Development from July 2006 to May 2008. While with Nutrisystem, Inc, Mr. Connerty was instrumental in successfully creating and implementing innovative direct marketing programs which contributed to that company s rapid growth. From 1999 to 2004, Mr. Connerty served as Vice President of Marketing at the Nautilus Group, where he played a key role in building the Bowflex division into one of the most profitable and recognizable names in the direct response home fitness market. Prior to Nautilus, Mr. Connerty served as the Vice President of Broadcast for the Home Shopping Network.

Mr. Richardson has served as the Company s Chairman of the Board of Directors since 2006. In March 2012, Mr. Richardson was appointed to perform the functions of the Company s principal financial officer and principal accounting officer. Mr. Richardson founded Prides Capital LLC and Prides Capital Partners LLC in January 2004 where he is Managing Director. Prides Capital LLC and Prides Capital Partners LLC specialize in strategic block, active investing in small- and micro-cap public and private companies. From April 1999 until the end of 2003, Mr. Richardson was a partner at Blum Capital Partners, a $2.5 billion investment firm. Between May 1999 and September 2003, Mr. Richardson was the lead public partner on 18 investments. Prior to joining Blum Capital, Mr. Richardson was an analyst at Tudor Investment Corporation, an investment management firm. Previously, Mr. Richardson spent four years at Fidelity Management and Research where he was the assistant portfolio manager of the Fidelity Contra Fund, a registered investment company. Mr. Richardson also managed Fidelity Airline Fund, the Fidelity Aerospace and Defense Fund, and performed research and analysis in a variety of industry sectors (computer services, business services, media, financial services, and healthcare information technology). Previously, Mr. Richardson worked at Kidder, Peabody & Co. Mr. Richardson is also a director of SANUWAVE Health, Inc., and previously served as a director of QC Holdings, Inc. until June 2007 and Healthtronics, Inc. until November 2008. Mr. Richardson received an M.B.A. from Kenan-Flagler Business School at the University of North Carolina. Mr. Richardson originally joined the Board of Directors in connection with the 2006 purchase of approximately 9.9 million shares of common stock by Prides Capital Fund I, LP, in which Prides Capital Partners LLC is general partner.

ITEM 1A. RISK FACTORS

We have experienced recurring operating losses and our liquidity has been significantly reduced, and we expect to continue incurring losses in the future.

For the year ended December 31, 2011, we had a net loss of $4.4 million and used $3.5 million of cash in operations. As of December 31, 2011, we had an accumulated deficit of $107.8 million and a total stockholders deficit of $1.3 million. As of December 31, 2011 and February 29, 2012 we had unrestricted cash of $0.6 million and $0.6 million, respectively. We may not achieve profitability in the future, and even if we do, we may not be able to sustain being profitable.

Due to uncertainty about our ability to meet our current operating expenses and capital expenditures, in their report on our annual financial statements for the year ended December 31, 2011, our independent registered public accounting firm stated that these conditions raise substantial doubt about the Company s ability to continue as a going concern. If we are unable to continue as a going concern, our stockholders will likely lose all of their investment in the Company.

We will be required to raise additional funds to finance our operations and remain a going concern; we may not be able to do so when necessary, and/or the terms of any financings may not be advantageous to us.

The continuation of our business is dependent upon raising additional financial support. In light of our results of operations, management has and intends to continue to evaluate various possibilities. These possibilities include: raising additional capital through the issuance of common or preferred stock, securities convertible into common stock, or secured or unsecured debt, selling one or more lines of business, or all or a portion of the Company s assets, entering into a business combination, reducing or eliminating operations, liquidating assets, or seeking relief through a filing under the U.S. Bankruptcy Code. These possibilities, to the extent available, may be on terms that result in significant dilution to our existing stockholders or that result in our existing stockholders losing all of their investment in the Company.

There can be no assurances that the Company will be successful in raising adequate additional financial support. If not, the Company will be required to reduce operations and/or liquidate assets and/or seek relief through a filing under the U.S. Bankruptcy Code. The Company s consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

We have no long-term credit facility or other source of long-term funding other than $1.0 million in Notes held by a former officer and directors of our Company (the Director Notes), and as of December 31, 2011, we had approximately $57,000 in accrued interest on the Director Notes that will mature on December 31, 2012.

We have no long-term credit facility or other source of long-term funding other than the Director Notes which represent: (i) a promissory note to Kevin A. Richardson, II, one of the Company s directors and an officer of Prides Capital Partners, LLC (Prides), pursuant to which the Company borrowed $600,000, (ii) a promissory note to Lee S. Isgur, one of the Company s directors, pursuant to which the Company borrowed $200,000 and (iii) a promissory note to Kevin N. McGrath, formerly one of the Company s directors and the Company s President and Chief Executive Officer, pursuant to which the Company borrowed $200,000. The Director Notes mature on December 31, 2012 at which time we must repay the original principal amount of $1.0 million, together with accrued interest of approximately $107,000. We do not believe that our cash flows from operations alone will be sufficient to support repayments and otherwise satisfy our repayment obligation under these Director Notes. Furthermore, even if we are able to refinance or extend the Director Notes, we will need additional financing to continue our operations. Based on our current financial condition, we may be unable to obtain such financing on commercially reasonable terms if at all. If we are unable to obtain third party financing, we will be required to pursue one or more alternative strategies, such as seeking additional equity capital, reducing operations, liquidating assets, or seeking relief through a filing under the U.S. Bankruptcy Code. Any such actions could adversely affect our financial condition and the value of our common stock.

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Our securities are quoted on the OTC Bulletin Board, which may limit the liquidity and price of our securities more than if our securities were quoted or listed on or a national securities exchange.

Our common stock is currently quoted for trading in the OTC Bulletin Board, which is generally considered to be a less efficient market than markets such as NASDAQ or other national exchanges, and which may cause difficulty in conducting trades and difficulty in obtaining future financing. Some investors may perceive our securities to be less attractive because they are traded in the over-the-counter market. In addition, as an OTC Bulletin Board quoted company, we do not attract the extensive analyst coverage that accompanies companies listed on a national securities exchange. Further, institutional and other investors may have investment guidelines that restrict or prohibit investing in securities traded in the over-the-counter market. These factors may have an adverse impact on the trading and price of our securities.

Economic conditions are adversely affecting consumer discretionary spending and may continue to negatively impact our business and operating results.

Because our meal delivery offerings consist of freshly prepared meals, they are priced higher than our major competitors such as Nutrisystem and Jenny Craig. The success of our meal delivery business is therefore dependent on customers willingness and ability to invest a larger percentage of discretionary spending in our meal delivery products than may be required with our competitors products. Because discretionary spending is influenced by general economic conditions, consumer confidence and the availability of discretionary income, a protracted economic slowdown, increased unemployment, decreased salaries and wage rates, increased energy prices, inflation, rising interest rates or other industry-wide cost pressures adversely affect consumer behavior and decrease consumer discretionary spending. A decline in our customers discretionary spending could adversely affect our business, financial condition, operating results and cash flows. If this difficult economic situation continues for a prolonged period of time or deepens in magnitude, our business and results of operations could be materially affected.

We may be forced to enter into business combinations and strategic alliances on unfavorable terms which may disrupt our business.

In order to continue our business, we may be required to enter into asset sales, business combinations, investments, joint ventures or other strategic alliances with other companies. To the extent we are able to find a purchaser or other joint venturer, due to our weak financial and operating condition, these transactions may be on highly unfavorable terms, which may materially adversely affect or eliminate the value of our common stock. If we are unable to consummate a transaction of this type, we may be required to cease operations.

Our future growth and profitability will depend in large part upon the effectiveness and efficiency of our marketing expenditures and our ability to select the right markets and media in which to advertise.

Our future growth and profitability will depend in large part upon the effectiveness and efficiency of our marketing expenditures, including our ability to:

- create greater awareness of our brand and our program;
- identify the most effective and efficient level of spending in each market, media and specific media vehicle;
- determine the appropriate creative message and media mix for advertising, marketing and promotional expenditures;
- effectively manage marketing costs (including creative and media) in order to maintain acceptable customer acquisition costs;
- select the right market, media and specific media vehicle in which to advertise; and
- convert consumer inquiries into actual orders.

Our planned marketing expenditures may not result in increased revenue or generate sufficient levels of brand name and program awareness. We may not be able to manage our marketing expenditures on a cost-effective basis whereby our customer acquisition cost may exceed the contribution profit generated from each additional customer.

As the largest stockholder, Prides has significant influence over our company.

As of March 16, 2012, Prides owned approximately 52.3% of our outstanding voting common stock based upon 14,310,534 shares outstanding. Therefore, as a practical matter, Prides has significant influence over the outcome of any stockholder vote, including the election of directors and the approval of mergers or other business combination transactions. Additionally, concentration of control in one stockholder may discourage potential investors from providing additional financing if we need it. Prides initially acquired our common stock under the terms of a 2006 Securities Purchase Agreement (the Company Purchase Agreement). The Company Purchase Agreement affords Prides certain participation rights and anti-dilution protections which could make it more difficult for us to obtain additional financing or to effect a merger or other business combination transaction. In addition, under the terms of the Company Purchase Agreement, as long as Prides owns at least 5% of our outstanding common stock, the following require the approval of a majority vote of our board of directors, which majority must include at least one Prides director:

- authorize, create, designate, establish or issue any other class or series of capital stock ranking senior to our capital stock as to dividends or upon liquidation, or reclassification of any shares of our capital stock into shares having any preference or priority as to dividends or upon liquidation superior to any such preference or priority of our common stock;

- adopt a plan for the liquidation, dissolution or winding up of the affairs of our company or any recapitalization plans;

- amend, alter or repeal, whether by merger, consolidation or otherwise our Certificate of Incorporation;

- alter or change the rights, preferences or privileges of our common stock or the warrants issued to Prides; or

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directly or indirectly, declare or pay any dividend (other than dividends payable in shares of our common stock) or directly or indirectly purchase, redeem, purchase or otherwise acquire any share of our common stock (except for shares of our common stock repurchased from current or former employees, consultants, or directors upon termination of service in accordance with plans approved by our board of directors (whether in cash, securities or property or in our obligations).

We face significant competition which may materially and adversely affect us.

Competition is intense in the weight management industry and we must remain competitive in the areas of program efficacy, price, taste, customer service and brand recognition. In addition to Weight Watchers® International, Inc., Waterfront Media, Inc. and Nutrisystem, Inc. we currently compete with several Internet sites which provide diet and nutrition information, including WeightWatchers.com. We know of several other online competitors aggressively marketing online programs which may be somewhat similar to ours, including some that are offered at no charge to the customer.

Increased competition and a proliferation of free online diet plans could result in reductions in the prices we receive for our programs, lower margins, loss of customers and reduced visitor traffic to our website.

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 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.

We rely on third parties to provide us with adequate food supply and certain fulfillment, the loss of which could cause our revenue, earnings or reputation to suffer.

Food Manufacturer. We currently depend on one third party meal delivery vendor for manufacture and fulfillment of our prepared meals. If we are unable to obtain sufficient quantity, quality and variety of food and fulfillment of customer orders in a timely and low-cost manner from this manufacturer, we will be unable to adequately fulfill our customers orders which would adversely affect our operating results and damage the value of our brand.

Freight and Fulfillment. Our orders are currently shipped by one third-party, United Parcel Service, Inc. (UPS). Should UPS be unable to service our needs for even a short duration, our revenue and business could be harmed. Additionally, the cost and time associated with replacing UPS on short notice would add to our costs. Any replacement fulfillment provider would also require startup time, which could cause us to lose sales and market share.

Therefore, we are dependent on maintaining good relationships with these third parties. The services we require from these parties may be disrupted by a number of factors associated with their businesses, including the following:

- labor disruptions;
- delivery problems;
- financial condition of operations;
- internal inefficiencies;
- equipment failure;
- natural or man-made disasters; and

with respect to our food supplier, shortages of ingredients or United States Department of Agriculture (USDA) and United States Food and Drug Administration (FDA) compliance issues.

We depend heavily on our network infrastructure and its failure could result in unanticipated expenses and prevent our subscribers from effectively utilizing our services, which could negatively impact our ability to attract and retain subscribers 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 subscribers from effectively utilizing our services, which could prevent us from retaining and attracting subscribers and advertisers. The hardware infrastructures on which our system operates are located in Chicago, Illinois and Lithia Springs, Georgia. We do not currently have a formal disaster recovery plan. Our system is susceptible to natural and man-made disasters, including war, terrorism, earthquakes, 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.

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In addition, our subscribers depend on Internet service providers, or ISPs, for access to our website. In the past, ISPs and websites 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 subscribers from effectively utilizing our services.

Problems with the performance and reliability of the Internet infrastructure could adversely affect the quality and reliability of the services we offer our subscribers.

We depend significantly on the Internet infrastructure to deliver attractive, reliable and timely e-mail messages to our subscribers. 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 subscribers and undermine our subscribers 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.

The unauthorized access of confidential member information that we transmit over public networks could adversely affect our ability to attract and retain subscribers.

Our subscribers 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 subscribers. 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.

Because of volatility in the advertising markets which we target, we may not be able to effectively attract and retain subscribers.

We are currently dependent in large part on the online and spot television advertising markets to attract and retain subscribers to our digital plans and meal delivery service. We expect competitive pressures to continue to increase in the future which may result in higher costs in these advertising markets, thereby significantly impacting our costs to acquire and retain subscribers. These competitive pressures may be even more significant in 2012, which is an election year. Although we are currently developing alternative channels of customer acquisition, including print advertising, there can be no assurance that these measures will as effectively attract and retain subscribers as have our online and television advertising programs in the past.

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. For example, we depend to a certain extent on Internet advertising, and we have been involved in both civil litigation and administrative proceedings arising out of pop-up ads and other advertising practices, in both cases brought by one of our competitors. If the outcome of 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.

If we engage in competitive advertising, we may be subject to litigation from our competitors.

If we engage in competitive advertising, our competitors may pursue litigation regardless of its merit and chances of success. Competitive advertising may include advertising that directly or indirectly mentions a competitor or a competitor s weight loss program in comparison to our program. Defending such litigation may be lengthy and costly, strain our resources and divert management s attention from their core responsibilities, which would have a negative impact on our business.

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We may be subject to health-related claims from our customers which may negatively affect our business.

Our weight loss program does not include medical treatment or medical advice, and we do not engage physicians or nurses to monitor the progress of our customers. Many people who are overweight suffer from other physical conditions, and our target consumers could be considered a high-risk population. A customer who experiences health problems could allege or bring a lawsuit against us on the basis that those problems were caused or worsened by participating in our weight management program. Currently, we are neither subject to any such allegations nor have we been named in any such litigation. However, if we were, we would defend ourselves against such claims. Defending ourselves against such claims, regardless of their merit and ultimate outcome, would likely be lengthy and costly, and adversely affect our results of operations. Further, our general liability insurance may not cover claims of these types.

If we cannot protect and enforce our trademarks and other intellectual property rights, our brand and our business will suffer.

We believe that our trademarks and other proprietary rights are important to our success and competitive position. The actions we take to establish and protect our trademarks and other proprietary rights may prove to be inadequate to prevent imitation of our products or services or to prevent others from claiming violations of their trademarks and proprietary rights by us. In addition, others may develop similar trademarks or other intellectual property independently or assert rights in our trademarks and other proprietary rights. If so, third parties may seek to block or limit sales of our products and services based on allegations that use of some of our marks or other intellectual property constitutes a violation of their intellectual property rights. If we cannot protect our trademarks and other intellectual property rights, or if our trademarks or other intellectual property rights infringe upon the rights of third parties, the value of our brand may decline, which would adversely affect our results of operations.

Our industry is subject to governmental regulation that could increase in severity and hurt results of operations.

Our industry is subject to federal, state and other governmental regulation. For example, some advertising practices in the weight loss industry have led to investigations from time to time by the FTC and other governmental agencies. Many companies in the weight loss industry have entered into consent decrees with the FTC relating to weight loss claims and other advertising practices. In October 2009, the FTC published revisions to its Guides Concerning the Use of Endorsements and Testimonials in Advertising. Among other things, the revised Guides require us to monitor the activities of bloggers and other third parties over whom we have limited control. Our inability to do so effectively could lead the FTC to bring administrative or legal action against us. Further, the revised Guides significantly affect our ability to advertise the successes our customers have achieved in losing weight through our programs. For example, we are no longer able to include the phrase results not typical in advertisements describing our customers successes. Uncertainties surrounding the application of the revised Guides may adversely affect our ability to advertise our programs effectively and may require us to incur significant additional costs. In addition, regulation of advertising practices in the weight loss industry may increase in scope or severity in the future, which could have a material adverse impact on our business.

Other aspects of our industry are also subject to government regulation. For example, food manufacturers are subject to rigorous inspection and other requirements of the USDA and FDA. If federal, state or local regulation of our industry increases for any reason, then we may be required to incur significant expenses, as well as modify our operations to comply with new regulatory requirements, which could harm our operating results. Additionally, remedies available in any potential administrative or regulatory actions may include requiring us to refund amounts paid by all affected customers or pay other damages, which could be substantial.

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 has recently enacted Internet legislation regarding children s privacy, commercial email, 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, including those at the state or local level, may be adopted that regulate the use of the Internet. These may include laws addressing user privacy, pricing, acceptable content, taxation, use of the telecommunications infrastructure, commercial email 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 impact our financial results and condition.

Our recent restructuring plan may adversely affect our ability to react to business developments and manage our business.

In order to manage our expenses and reduce our use of our limited cash, we have implemented reductions in force over the last several reporting periods which significantly reduced the number of our employees. These reductions may adversely affect our ability to react to business developments, grow our revenue or manage our business, which would have a negative impact on the financial condition of the Company and the value of our common stock.

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The price of our common stock is likely to be volatile which could adversely affect the market price of our common stock.

In the past year, our stock has closed at prices ranging from a high of $3.60 on February 18, 2011, to a low of $0.20 on December 16, 2011. We expect our market price to continue to be extremely volatile. The market price of our common stock is also subject to fluctuations in response to general trends in the weight loss industry, seasonality, announcements by our competitors, our ability to meet or exceed securities analysts expectations, recommendations by securities analysts, the condition of the financial markets and other factors. In addition, short-term trading strategies of certain investors can also have a significant effect on the price of specific securities and the concentration of ownership of our stock could lead to heightened volatility even if relatively few shares are traded. These fluctuations, as well as general economic and market conditions, may adversely affect the market price of our common stock and cause it to fluctuate significantly.

The exercise of warrants or options may depress our stock price.

There are a significant number of warrants and options to purchase our common stock outstanding at prices ranging from $0.27 to $30.15 per share. Holders may sell the common stock acquired upon exercise of the warrants and options at a market price that exceeds the exercise price of the warrants and options paid by the holders. Sales of a substantial number of shares of common stock in the public market by holders of warrants or options may depress the prevailing market price for our common stock and could impair our ability to raise capital through the future sale of our equity securities.

We have authorized but unissued preferred stock, which could negatively affect rights of holders of our common stock.

Our certificate of incorporation authorizes the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

If we do not keep pace with rapid technological change in the e-commerce and Internet subscription diet and wellness plan industries our business could be harmed.

In order to remain competitive, we will be continually required to enhance and to improve the functionality and features of our subscription products and website, which could require us to invest significant capital. If our competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing services, technology, and systems may become obsolete and we may not have the funds or technical know-how to upgrade our services, technology, and systems. We may face material delays in introducing new services, products, and enhancements. If such delays occur, our users may forego use of our services and select those of our competitors, in which event, our business, prospects, financial condition and results of operations could be materially adversely affected.

The sale of prepared meals and nutritional supplements involves product liability and other risks.

We face an inherent risk of exposure to product liability claims if the use of our prepared meal delivery products and nutritional supplements results in illness or injury. We are subject to various laws and regulations, including those administered by the United States Department of Agriculture and Food and Drug Administration, that establish manufacturing practices and quality standards for food products. We may be subject to claims that our products contain contaminants, are improperly labeled, include inadequate instructions as to use or inadequate warnings. Product liability claims could have a material adverse effect on our business as our contract indemnification rights and existing insurance coverage may not be adequate. Distributors of food products, vitamins, and nutritional supplements are frequently named as defendants in product liability lawsuits. The successful assertion or settlement of an uninsured claim, a significant number of insured claims or a claim exceeding the limits of our insurance coverage would harm us by adding costs to the business and by diverting the attention of senior management. Product liability litigation or regulatory action, even if not meritorious, is very expensive and could also entail adverse publicity for us and reduce our revenue.

Provisions in our certificate of incorporation may deter or delay an acquisition of us or prevent a change in control, even if an acquisition or a change of control would be beneficial to our stockholders.

Provisions of our certificate of incorporation may have the effect of deterring unsolicited takeovers or delaying or preventing a third party from acquiring control of us, even if our stockholders might otherwise receive a premium for their shares over then current market prices. In addition, these provisions may limit the ability of stockholders to approve transactions that they may deem to be in their best interests.

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Our certificate of incorporation permits our Board of Directors to issue preferred stock without stockholder approval upon such terms as the Board of Directors may determine. The rights of the holders of our common stock may be junior to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a majority of our outstanding common stock. The issuance of a substantial number of preferred shares could adversely affect the price of our common stock.

The loss of services of our executive management personnel or our inability to hire additional executive management personnel may negatively affect our business.

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. If we are unable to attract and retain additional qualified personnel, our business could suffer.

Changes in consumer preferences could negatively impact our operating results.

Our program features pre-packaged food selections, which we believe offer convenience and value to our customers. Our continued success depends, to a large degree, upon the continued popularity of our program versus various other weight loss, weight management and fitness regimens, such as low carbohydrate diets, appetite suppressants and diets featured in the published media. Changes in consumer tastes and preferences away from our weight loss oriented meal delivery service and digital weight-loss programs, and any failure to provide innovative responses to these changes, may have a materially adverse impact on our business, financial condition, operating results, cash flows and prospects.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our employees operate out of our leased facility of approximately 20,000 square feet in Fort Lauderdale, Florida. Our lease is due to expire in September 2016. The aggregate current monthly rental, including lessor leasehold improvements repayment obligations and pro-rated share of common area facilities expenses, is approximately $53,000.

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.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock traded on The Nasdaq Capital Market until December 2011 and currently trades on OTC Bulletin Board under the symbol DIET.OB. The following table sets forth the high and the low sales prices for the common stock as quoted on The Nasdaq Capital Market and the OTC Bulletin Board for the periods indicated.

	LOW	HIGH
YEAR ENDED DECEMBER 31, 2011:		
Fourth quarter	$ 0.19	$ 1.34
Third quarter	$ 1.02	$ 1.83
Second quarter	$ 1.30	$ 2.98
First quarter	$ 1.40	$ 3.95

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	LOW	HIGH
YEAR ENDED DECEMBER 31, 2010:		
Fourth quarter	$ 0.46	$ 0.99
Third quarter	$ 0.57	$ 0.92
Second quarter	$ 0.68	$ 1.52
First quarter	$ 1.11	$ 2.00

As of March 16, 2012, there were approximately 87 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.

Equity Compensation Plan Information

The Company has two employee equity plans: (1) its Stock Option Plan, initially adopted in 1999, as amended and restated in April 2002 and as further amended in October 2009 (the 1999 Plan) and (2) its Equity Incentive Plan initially adopted in 2004, as amended and restated in 2010 (as further amended, the 2010 Plan). The 1999 Plan expired in November 2009 and no additional grants may be awarded under the 1999 Plan following its expiration. The 2010 Plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock units, deferred stock and unrestricted stock. In December 2011, the Compensation Committee adopted an amendment to the 2010 Plan to increase the maximum number of shares that may be issued under the 2010 Plan from 2.0 million to 4.0 million. This amendment has not been approved by the Company s security holders.

The following table sets forth information as of December 31, 2011 about the securities authorized for issuance under the Company s equity compensation plans, consisting of the 1999 Plan and the 2010 Plan.

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)**
Equity compensation plans approved by the security holders			
1999 Plan	52,250	$ 14.61	(1)
2010 Plan	1,956,935(2)	$ 5.09(2)	1,868,187
Equity compensation plans not approved by security holders			
Total	2,009,185	$ 5.34	1,868,187

(1) This plan has been terminated and we are no longer eligible to issue shares pursuant to the plan.

(2) Included in the number of securities in column (a) is approximately 99,800 restricted stock units, which have no exercise price. The weighted average exercise price of Outstanding Options, Warrants and Rights (excluding restricted stock units) under the 2010 Plan is $5.36.

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ITEM 6. SELECTED FINANCIAL DATA

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, 2011. 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.

	YEAR ENDED DECEMBER 31, (in thousands, except per share data)				
	2011	2010	2009	2008	2007
Consolidated Statement of Operations Data:					
Revenue					
Digital plans	$ 2,551	$ 3,745	$ 4,970	$ 9,345	$ 19,482
Meal delivery	17,653	16,239	7,839	9,405	3,994
Business-to-business	1,088	2,499	4,054	3,646	2,573
Other	771	874	1,245	1,539	3,680

	YEAR ENDED DECEMBER 31, (in thousands, except per share data)				
	2011	2010	2009	2008	2007
Total Revenue	$ 22,063	$ 23,357	$ 18,108	$ 23,935	$ 29,729
Costs and Expenses:					
Cost of revenue					
Digital plans	245	515	863	2,610	3,112
Meal delivery	10,117	10,599	5,912	9,358	3,665
Business-to-business	93	130	198	136	200
Other	115	180	236	321	245
Total cost of revenue	10,570	11,424	7,209	12,425	7,222
Technology and development	1,075	2,801	3,710	4,297	3,723
Sales, marketing and support	10,913	14,003	8,896	11,664	17,029
General and administrative	3,836	4,595	4,882	6,070	6,984
Amortization of intangible assets	14	31	295	882	1,213
Impairment of goodwill and intangible assets		6,865		5,191	2,296
Total costs and expenses	26,408	39,719	24,992	40,529	38,467
Loss from operations	(4,345)	(16,362)	(6,884)	(16,594)	(8,738)
Interest income		3	11	109	282
Interest expense	(53)	(2,741)	(5,170)	(3,357)	(781)
Interest expense incurred with debt conversion		(23,961)			
Loss on extinguishment of related party debt		(213)			
Loss before income tax provision	(4,398)	(43,274)	(12,043)	(19,842)	(9,237)
Income tax benefit (provision)	4	1	(18)	(6)	(171)
Net loss	$ (4,394)	$ (43,273)	$ (12,061)	$ (19,848)	$ (9,408)
Loss per common share:					
Basic and diluted loss per common share:	$ (0.34)	$ (4.68)	$ (2.34)	$ (3.95)	$ (1.90)
Weighted average common and common equivalent shares outstanding:					
Basic and diluted	12,886	9,252	5,144	5,023	4,962

	YEAR ENDED DECEMBER 31,				
	2011	2010	2009	2008	2007
			(in thousands)		
Consolidated Statement of Cash Flows Data:					
Net cash provided by (used in):					
Operating activities	$ (3,482)	$ (7,161)	$ (4,590)	$ (8,202)	$ (4,774)
Investing activities	(34)	(459)	(74)	(1,148)	(4,062)
Financing activities	3,651	6,497	3,637	4,652	10,009

	DECEMBER 31,				
	2011	2010	2009	2008	2007
			(in thousands)		
Consolidated Balance Sheet Data:					
Total assets	$ 2,696	$ 3,596	$ 12,456	$ 15,671	$ 27,691
Total debt	1,023	1,044	16,890	11,958	7,029
Debt (excluding capital lease obligations)	1,000	1,000	16,824	11,808	6,247
Stockholders (deficit) equity	(1,346)	(1,970)	(9,570)	(2,781)	12,862

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS RESULTS OF OPERATIONS

Going concern and continuing operations

Our consolidated financial statements have been prepared assuming we will continue as a going concern. For the year ended December 31, 2011, we had a net loss of approximately $4.4 million and used approximately $3.5 million of cash in our operations. As of December 31, 2011, we had an accumulated deficit of approximately $107.8 million, total stockholders deficit of approximately $1.3 million and our unrestricted cash balance was approximately $0.6 million.

Due to uncertainty about our ability to meet our current operating expenses, debt obligations and capital expenditures, in their report on our annual financial statements for the year ended December 31, 2011, our independent registered public accounting firm included an explanatory paragraph regarding our ability to continue as a going concern. Our debt consists of $1.0 million of principal of related party notes (the Director Notes) as of December 31, 2011. The entire outstanding principal balance of the Director Notes, together with all accrued and unpaid interest, was originally due and payable on December 31, 2011. On December 30, 2011, we executed amendments to the Director Notes to extend the maturity date of the Director Notes to December 31, 2012.

The continuation of our business is dependent upon raising additional financial support. In light of our results of operations, management has and intends to continue to evaluate various possibilities. These possibilities include: raising additional capital through the issuance of common or preferred stock, securities convertible into common stock, or secured or unsecured debt, selling one or more lines of business, or all or a portion of the Company s assets, entering into a business combination, reducing or eliminating operations, liquidating assets, or seeking relief through a filing under the U.S. Bankruptcy Code. These possibilities, to the extent available, may be on terms that result in significant dilution to our existing stockholders or that result in our existing stockholders losing all of their investment in the Company.

There can be no assurances that the Company will be successful in raising adequate additional financial support. If not, the Company will be required to reduce operations and/or liquidate assets and/or seek relief through a filing under the U.S. Bankruptcy Code. The Company s consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

Our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern. Our consolidated financial statements have been prepared assuming we will continue as a going concern.

The following table sets forth our results of operations expressed as a percentage of total revenue:

	YEAR ENDED DECEMBER 31,		
	2011	**2010**	**2009**
Revenue	100%	100%	100%
Cost of revenue	48	49	40
Technology and development	5	12	20
Sales, marketing and support	50	60	49
General and administrative	17	20	27
Amortization of intangible assets	*	*	2
Impairment of goodwill and intangible assets		29	
Other income		*	*
Interest expense	*	12	29
Interest expense incurred with debt conversion		103	
Loss on extinguishment of related party debt		*	
Income tax provision	*	*	*
Net loss	(20)%	(185)%	(67)%

* Less than 1%

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COMPARISON OF THE YEARS ENDED DECEMBER 31, 2011 AND DECEMBER 31, 2010

Revenue: Total revenue for the year ended December 31, 2011 was approximately $22.1 million, a decrease of approximately 6% versus the $23.4 million recorded for the year ended December 31, 2010.

Revenue by type for the years ended December 31, 2011 and 2010 is as follows (in thousands):

	2011	2010
Digital plans	$ 2,551	$ 3,745
Meal delivery	17,653	16,239
Business-to-business	1,088	2,499
Advertising and Ecommerce	174	249
Royalties	597	625
	$ 22,063	$ 23,357

Digital plans revenue was approximately $2.6 million and $3.7 million for the years ended December 31, 2011 and 2010, respectively. Digital plans revenue is driven by the following two factors: the average number of digital plans subscribers and the average weekly fee paid by digital plans subscribers. For the year ended December 31, 2011, the average number of paying subscribers was approximately 35% lower than the corresponding prior year period and the average weekly fees were approximately 2% lower than the corresponding prior year period. The number of overall active digital subscribers continues to decline. Due to cash constraints and uncertain returns from online advertising, we target more of our advertising investments in general to meal delivery. Increased competition, the growth of similar services that are offered for free, economic conditions, and our reduction in online advertising expenditures have all contributed to the decline in digital subscribers during the last several reporting periods and our current number of subscribers is insufficient to sustain our liquidity. Our advertising is now driving potential customers to our call center rather than to our website. As a result of these factors and to offset further decreases in the liquidity of the digital business, we have diversified from a digital subscription-only model to a more integrated business model that includes the sale of food and other weight-loss products which we believe may permit us to better capture cross-selling opportunities and leverage our existing customer relationships.

Meal delivery had revenues of approximately $17.7 million and $16.2 million, including shipping revenue, in fiscal years 2011 and 2010, respectively, representing an increase of approximately 9% for 2011. The increase in meal delivery revenue for the year ended December 31, 2011 as compared to the year ended December 31, 2010 is directly related to an approximately 6% increase in meals shipped during the twelve months ended December 31, 2011 as compared to the same period of the prior year, as well as an overall price increase which took place in 2011. We have expanded our meal delivery promotional offerings in order to achieve a higher volume of shipments, but we have also decreased our offline advertising expense by approximately 36% compared the year ended December 31, 2010 in an effort to manage our customer acquisition cost and reduce our cash burn rate.

Business-to-business revenues, which are comprised of application development and license-related revenues, were approximately $1.1 million and $2.5 million for the years ended December 31, 2011 and 2010, respectively. Development revenue and licensing revenue decreased during the year ended December 31, 2011 as a result of a lack of new contract awards over the last several reporting periods and previous contracts not being renewed upon expiration. Our current customers are also using less of our consulting and support services compared to prior reporting periods, contributing to the continued business-to-business revenue decline.

Advertising revenue from our website, our newsletter and ecommerce revenue was approximately $0.2 million and $0.2 million for both the years ended December 31, 2011 and 2010. We have fewer site visitors who observe third-party banner impressions now as compared to prior reporting periods. The number of visitors to our websites has declined over the last few reporting periods because more of our sales traffic is going through our call center versus our website. We are also allocating a greater share of our website to advertisements for our own products rather than advertisements for other companies products which may result in a decrease in advertising revenue.

Royalty revenues related to our licensing agreement with Tesco were approximately $0.6 million and $0.6 million for the years ended December 31, 2011 and 2010, respectively, remaining flat year over year.

In the future we expect that revenue streams from meal delivery will continue to be a larger share of total revenue.

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Cost of Revenue: Total cost of revenue was approximately $10.6 million for the year ended December 31, 2011 as compared to $11.4 million for the prior year.

Cost of revenue by type for the years ended December 31, 2011 and 2010 is as follows (in thousands):

	2011	2010
Digital plans	$ 245	$ 515
Meal delivery	10,117	10,599
Business-to-business	93	130
Other	115	180
Total cost of revenue	$ 10,570	$ 11,424

Consolidated gross margin increased slightly to approximately 52% for the year ended December 31, 2011 as compared to approximately 51% for the corresponding prior year period. The increase in the consolidated gross margin for the year ended December 31, 2011 as compared to the same period last year is the result of an increase in our meal delivery gross margin to approximately 43% from 35% in the same period of the prior year. We currently have a higher mix of meal delivery revenue for the past few reporting periods which has created an increase in lower-margin meal delivery revenue and a decrease in high-margin digital plans revenue and a decrease in high-margin business-to-business revenue. The improvement in our meal delivery gross margin over the corresponding prior year period is the result of continued cost reductions from stabilizing our technology platform, a reduction in product costs and food production efficiencies realized with our primary food vendors, and a reduction in our shipping costs. Gross margin for digital plans increased to approximately 90% for the year ended December 31, 2011 as compared to approximately 86% for the corresponding prior year period. This increase is primarily the result of the continued stabilization of our technology platform, terminating certain revenue share arrangements and a decrease in the amount included within digital plans cost of sales relating to our call center. Business-to-business gross margin decreased during the year ended December 31, 2011 to approximately 92% as compared to 95% in the corresponding prior year period.

Cost of digital plans revenue consists primarily of variable costs such as credit card fees and revenue sharing or royalty costs related to the exclusive license agreements with third party nutrition and fitness companies. Other costs include Internet access fees, compensation for nutritional and consulting professionals and depreciation. Cost of digital plans revenue decreased to approximately $0.2 million for the year ended December 31, 2011 as compared to $0.5 million in the corresponding prior year period primarily because variable costs declined in conjunction with the decline in subscribers mentioned above.

Cost of meal delivery revenue consists primarily of variable costs such as credit card fees, product costs, fulfillment and shipping costs, as well as costs associated with revenue share arrangements, depreciation and promotional costs. Cost of meal delivery revenue decreased to approximately $10.1 million for the year ended December 31, 2011 from $10.6 million for the year ended December 31, 2010. Cost of meal delivery revenue decreased as a result of continued cost reductions from stabilizing our technology platform, a reduction in product costs and food production efficiencies realized with our primary food vendors, and a reduction in our shipping costs.

Cost of business-to-business revenue consists primarily of Internet access fees to support our business customers. Cost of business-to-business revenue was approximately $0.1 million for both the years ended December 31, 2011 and 2010.

Cost of other revenue consists primarily of Internet serving fees, product and fulfillment costs for ecommerce sales and credit card fees. Cost of other revenue was approximately $0.1 million and $0.2 million for the years ended December 31, 2011 and 2010, respectively.

Technology and Development: Technology and development expenses consist of payroll and related expenses we incur related to testing, maintaining and modifying our websites, telecommunication systems and infrastructure and other internal-use software systems. Technology and development expenses also include depreciation of the computer hardware and capitalized software we use to run our website and store our data. These expenses were approximately $1.1 million for 2011 as compared to $2.8 million in 2010. Technology and development compensation expenses were lower during 2011, primarily due to reductions in headcount.

Sales, Marketing and Support Expense: Sales, marketing and support expenses consist primarily of Internet advertising expenses and compensation for employees in those departments related to promoting our digital and meal delivery subscription plans. These expenses decreased to approximately $10.9 million in 2011 from $14.0 million in 2010 and represent mainly advertising media expense and compensation expense. This decrease is primarily the result of a decrease in offline advertising expense. In total, advertising media expense (television, print and internet advertising) was approximately $6.3 million in 2011 versus $9.0 million in 2010. Additionally, costs of producing our advertisements, such as production costs relating to new television commercials or print advertisements, totaled approximately $0.2 million and $0.3 million during the years ended December 31, 2011 and 2010, respectively. The higher advertising spend in 2010 compared to 2011 was a result of implementing a new offline advertising campaign during the prior year and we also launched and expensed two new commercials during 2010. The expenses associated with another component of our sales process, our call center, increased during 2011 as we added staff and incentives to drive higher sales.

General and Administrative Expenses: General and administrative expenses consist primarily of salaries, overhead and related costs for general corporate functions, including professional fees. General and administrative expenses were approximately $3.8 million for the year ended December 31, 2011 as compared to $4.6 million in the corresponding prior year period. Overall, in an effort to reduce costs, the Company reduced overall general and administrative compensation expense during 2011. In addition, the current year decrease is also the result of lower professional fees, lower legal fees and a decrease in recruiting expense, as well as a reduction in insurance premiums during 2011.

Amortization of Intangible Assets: Amortization expense for 2011 relates primarily to intangible assets such as patents, trademarks and other intangible assets related to our meal delivery business. Amortization expense for 2010 relates primarily to the intangible assets acquired in the 2006 Nutrio acquisition. Amortization expense was approximately $14,000 and $31,000 for the years ended December 31, 2011 and 2010, respectively. The reduction in amortization expense during 2011 is the result of certain Nutrio intangibles being completely amortized or impaired during 2010.

Impairment of Goodwill and Intangible Assets: During the second quarter of 2010, we performed additional impairment assessments of the U.S. business-to-business reporting unit in anticipation that certain customer contracts would not be renewed and that certain new contract opportunities would be delayed or cancelled due to customer concerns regarding economic uncertainty. As a result, we determined that goodwill and intangible assets, specifically the Nutrio tradename, were fully impaired. This resulted in a non-cash impairment of goodwill and intangible assets of approximately $6.9 million, which is included in the Consolidated Statement of Operations under Impairment of goodwill and intangible assets during 2010.

Interest Income: Interest income was less than $0.1 million for both of the years ended December 31, 2011 and 2010.

Interest Expense: Interest expense decreased to approximately $53,000 for the year ended December 31, 2011 from $2.7 million for the corresponding period of the prior year. Interest expense during 2011 relates to interest expense on $1.0 million of principal of related party notes (the Director Notes) issued in November 2010. Interest expense during 2010 relates primarily to interest costs and the amortization of discounts and issuance costs recorded in connection with the senior secured notes issued in August 2007, May 2008 and November 2008, which were converted into shares of our common stock on June 4, 2010.

Interest Expense Incurred With Debt Conversion: In connection with converting our senior secured notes into shares of our common stock on June 4, 2010, we also adjusted for the remaining balance of the beneficial conversion feature discounts, warrant discounts, and issuance cost discounts which totaled approximately $1.9 million and additional interest expense incurred relating to the reduction in the original conversion prices totaled approximately $22.1 million.

Loss on Extinguishment of Related Party Debt: In connection with converting our senior secured notes into shares of our common stock on June 4, 2010, we also converted a related party note into shares of our common stock. We incurred a loss on the extinguishment of this related party note of approximately $0.2 million during the year ended December 31, 2010.

Income Tax Benefit (Provision): Income tax benefit (provision) of less than $0.1 million for the years ended December 31, 2011 and 2010 relates to eDiets Europe. The income tax benefit during the year ended December 31, 2011 represents an adjustment to an income tax accrual.

Net Loss: As a result of the factors discussed above, we recorded a net loss of approximately $4.4 million in 2011 compared to a net loss of $43.3 million in 2010.

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COMPARISON OF THE YEARS ENDED DECEMBER 31, 2010 AND DECEMBER 31, 2009

Revenue: Total revenue for the year ended December 31, 2010 was approximately $23.4 million, an increase of approximately 29% versus the $18.1 million recorded for the year ended December 31, 2009.

Revenue by type for the years ended December 31, 2010 and 2009 is as follows (in thousands):

	2010	2009
Digital plans	$ 3,745	$ 4,970
Meal delivery	16,239	7,839
Business-to-business	2,499	4,054
Advertising	212	702
Ecommerce	37	20
Royalties	625	523
	$ 23,357	$ 18,108

Digital plans revenue was approximately $3.7 million and $5.0 million for the years ended December 31, 2010 and 2009, respectively. Digital plans revenue is driven by the following two factors: the average number of digital plans subscribers and the average weekly fee paid by digital plans subscribers. For the year ended December 31, 2010, the average number of paying subscribers was approximately 15% lower than the corresponding prior year period and the average weekly fees were approximately 3% lower than the corresponding prior year period. Fewer digital plans subscribers were added for the year 2010 compared to 2009. Due to cash constraints and uncertain returns from online advertising, we targeted more of our advertising investments in general to meal delivery. Increased competition, the growth of similar services that are offered for free, economic conditions, and our reduction in online advertising expenditures contributed to the decline in subscribers during 2010.

Meal delivery had revenues of approximately $16.2 million and $7.8 million, including shipping revenue, in fiscal years 2010 and 2009, respectively, representing an increase of approximately 107% for 2010. The increase in meal delivery revenue for the year ended December 31, 2010 as compared to the year ended December 31, 2009 is directly related to an approximately 115% increase in meals shipped during the twelve months ended December 31, 2010 as compared to the same period of the prior year. We have expanded our meal delivery promotional offerings in order to achieve a higher volume of shipments which impacted our net revenues for 2010. During the year ended December 31, 2010, we increased our offline advertising expense by approximately 258% over the year ended December 31, 2009.

Business-to-business revenues, which are primarily license related revenues, were approximately $2.5 million and $4.1 million for the years ended December 31, 2010 and 2009, respectively. During 2009, an eDiets Corporate Services contract was terminated and resulted in the acceleration of approximately $0.6 million in previously deferred revenue which was recognized during the first quarter of 2009. Additionally, other development revenue decreased during the year ended December 31, 2010 as a result of contracts not being renewed upon expiration in either late 2009 or during 2010. In 2010, our customers were using less of our consulting and support services compared to 2009, contributing to the business-to-business revenue decline.

Advertising revenue from our website and our newsletter and Ecommerce revenue was approximately $0.2 million and $0.7 million for the years ended December 31, 2010 and 2009, respectively. The decrease was due to fewer site visitors who observe third-party banner impressions in 2010 as compared to 2009. The number of visitors to our websites declined in 2010 because our advertising was driving potential customers to our call center rather than our website. We also allocated a greater share of the website to advertisements for our own products rather than advertisements for other companies   products.

Royalty revenues related to our licensing agreement with Tesco were approximately $0.6 million and $0.5 million for the years ended December 31, 2010 and 2009, respectively.

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Cost of Revenue: Total cost of revenue was approximately $11.4 million for the year ended December 31, 2010 as compared to $7.2 million for the prior year.

Cost of revenue by type for the years ended December 31, 2010 and 2009 is as follows (in thousands):

	2010	2009
Digital plans	$ 515	$ 863
Meal delivery	10,599	5,912
Business-to-business	130	198
Other	180	236
Total cost of revenue	$ 11,424	$ 7,209

Consolidated gross margin decreased to approximately 51% for the year ended December 31, 2010 as compared to approximately 60% for the corresponding prior year period. The decrease in the consolidated gross margin for the year ended December 31, 2010 as compared to the prior year period is the result of a shift in revenue mix. The increase in lower-margin meal delivery revenue combined with the decrease in high-margin digital plans revenue and the decrease in high-margin business-to-business revenue during 2010 as compared to 2009 is the reason that consolidated gross margin declined. Gross margin for digital plans increased to approximately 86% for the year ended December 31, 2010 as compared to approximately 83% for the corresponding prior year period. This increase is primarily the result of the continued stabilization of our technology platform, terminating certain revenue share arrangements and a decrease in the amount included within digital plans cost of sales relating to our call center. Meal delivery gross margin increased to approximately 35% for the year ended December 31, 2010 as compared to approximately 25% for the corresponding prior year period. This is the result of continued cost reductions from stabilizing our technology platform, a reduction in product costs and food production efficiencies realized with our primary food vendors, and a reduction in our shipping costs. Business-to-business gross margin remained flat during year ended December 31, 2010 as compared to the corresponding prior year period.

Cost of digital plans revenue consists primarily of variable costs such as credit card fees and revenue sharing or royalty costs related to the exclusive license agreements with third party nutrition and fitness companies. Other costs include Internet access fees, compensation for nutritional and consulting professionals and depreciation. Cost of digital plans revenue decreased to approximately $0.5 million for the year ended December 31, 2010 as compared to $0.9 million in the corresponding prior year period primarily because variable costs declined in conjunction with the decline in subscribers mentioned above.

Cost of meal delivery revenue consists primarily of variable costs such as credit card fees, product costs, fulfillment and shipping costs, as well as costs associated with revenue share arrangements, depreciation and promotional costs. Cost of meal delivery revenue increased to approximately $10.6 million for the year ended December 31, 2010 from $5.9 million for the year ended December 31, 2009. Cost of meal delivery revenue increased because the variable costs increased as a result of the increased revenue levels mentioned above.

Cost of business-to-business revenue consists primarily of Internet access fees to support our business customers. Cost of business-to-business revenue was approximately $0.1 million for the year ended December 31, 2010 and $0.2 million for the year ended December 31, 2009.

Cost of other revenue consists primarily of Internet serving fees, product and fulfillment costs for ecommerce sales and credit card fees. Cost of other revenue was approximately $0.2 million and $0.2 million for the years ended December 31, 2010 and 2009, respectively.

Technology and Development: Technology and development expenses consist of payroll and related expenses we incur related to testing, maintaining and modifying our websites, telecommunication systems and infrastructure and other internal-use software systems. Technology and development expenses also include depreciation of the computer hardware and capitalized software we use to run our website and store our data. These expenses were approximately $2.8 million for 2010 as compared to $3.7 million in 2009. Technology and development compensation expenses were lower during 2010, primarily due to a reduction in headcount.

Sales, Marketing and Support Expense: Sales, marketing and support expenses consist primarily of Internet advertising expenses and compensation for employees in those departments related to promoting our digital and meal delivery subscription plans. These expenses increased to approximately $14.0 million in 2010 from $8.9 million in 2009 and represent mainly advertising media expense and compensation expense. The increase is primarily the result of an increase in offline advertising expense. In total, advertising media expense (television, print and internet advertising) was approximately $9.0 million in 2010 versus $3.7 million in 2009. During the first quarter of 2010, we implemented a new offline advertising campaign and we also launched and expensed two new commercials during 2010. The expenses associated with another component of our sales process, our call center, increased as we added staff and incentives to drive higher sales.

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General and Administrative Expenses: General and administrative expenses consist primarily of salaries, overhead and related costs for general corporate functions, including professional fees. General and administrative expenses were approximately $4.6 million for the year ended December 31, 2010 as compared to $4.9 million in the corresponding prior year period. Overall, in an effort to reduce costs, the Company reduced overall general and administrative compensation expense during 2010. In addition, the decrease in 2010 is the result of lower professional fees and a reduction in insurance premiums during 2010.

Amortization of Intangible Assets: Amortization expense relates primarily to the intangible assets acquired in the 2006 Nutrio acquisition. Amortization expense was approximately $31,000 and $0.3 million for the years ended December 31, 2010 and 2009, respectively. The reduction in amortization expense during 2010 is the result of certain Nutrio intangibles being completely amortized.

Impairment of Goodwill and Intangible Assets: During the second quarter of 2010, we performed additional impairment assessments of the U.S. business-to-business reporting unit in anticipation that certain customer contracts would not be renewed and that certain new contract opportunities would be delayed or cancelled due to customer concerns regarding economic uncertainty. As a result, we determined that goodwill and intangible assets, specifically the Nutrio tradename, were fully impaired. This resulted in a non-cash impairment of goodwill and intangible assets of approximately $6.9 million, which is included in the Consolidated Statement of Operations under Impairment of goodwill and intangible assets during 2010.

Interest Income: Interest income was less than $0.1 million for the years ended December 31, 2010 and 2009.

Interest Expense: Interest expense decreased to approximately $2.7 million for the year ended December 31, 2010 as compared to $5.2 million for the corresponding period of the prior year. Interest expense relates primarily to interest costs and the amortization of discounts and issuance costs recorded in connection with the senior secured notes issued in August 2007, May 2008 and November 2008, which were converted into shares of our common stock on June 4, 2010.

Interest Expense Incurred With Debt Conversion: In connection with converting our senior secured notes into shares of our common stock on June 4, 2010, we also adjusted for the remaining balance of the beneficial conversion feature discounts, warrant discounts, and issuance cost discounts which totaled approximately $1.9 million and additional interest expense incurred relating to the reduction in the original conversion prices totaled approximately $22.1 million.

Loss on Extinguishment of Related Party Debt: In connection with converting our senior secured notes into shares of our common stock on June 4, 2010, we also converted a related party note into shares of our common stock. We incurred a loss on the extinguishment of this related party note of approximately $0.2 million during the year ended December 31, 2010.

Income Tax Benefit (Provision): Income tax benefit (provision) of less than $0.1 million for the years ended December 31, 2010 and 2009 relates to eDiets Europe.

Net Loss: As a result of the factors discussed above, we recorded a net loss of $43.3 million in 2010 compared to a net loss of $12.1 million for 2009.

LIQUIDITY AND CAPITAL RESOURCES

The Company s principal use of cash in its operating activities for the year ended December 31, 2011 was for television and print advertising promoting our meal delivery programs to potential subscribers and to support our business infrastructure. Advertising expense in the first half of the year usually exceeds advertising in the second half of the year due to seasonality in the weight loss business. As a result, we have historically experienced proportionally lower or negative cash flows from operating activities in the first six months of each year. However, during both the first and second quarters of 2011, we reduced advertising spend in an effort to manage our customer acquisition cost and reduce our cash burn. The amount of advertising and its effectiveness is a significant driver of our operations. Our advertising commitments are typically short term in nature with most of it purchased on the spot market.

During November 2010, the Company issued the Director Notes, consisting of (i) a promissory note to Kevin A. Richardson, II, one of the Company s directors and an officer of Prides, pursuant to which the Company borrowed $600,000, (ii) a promissory note to Lee S. Isgur, one of the Company s directors, pursuant to which the Company borrowed $200,000 and (iii) a promissory note to Kevin N. McGrath, who at that time was one of the Company s directors and the Company s President and Chief Executive Officer, pursuant to which the Company borrowed $200,000. The entire outstanding principal balance of the Director Notes, together with all accrued and unpaid interest, is due and payable on December 31, 2012. Interest accrues on the Director Notes at a rate of five percent (5%) per annum. In the event the principal is not paid in full within three business days of the due date, or any other default occurs thereunder, then interest shall accrue on the outstanding principal balance of the Director Notes at a rate of ten percent (10%) per annum.

During February 2011, the Company executed Subscription Agreements with a group of four investors pursuant to which approximately 762,364 shares of the Company s common stock were issued under a private placement, which provided approximately $1.6 million of capital. The investors included Kevin A. Richardson, II and Lee S. Isgur, two of the Company s directors, who entered into Subscription Agreements for approximately $0.8 million and $0.1 million, respectively. The Subscription Agreements require that if the Company proposes to offer, issue or sell any Company common stock or securities convertible into common stock in a private placement prior to August 7, 2012, the Company must provide the investors with the opportunity to purchase an equal number of

Company common stock or securities convertible into common stock on the same terms and conditions. The Subscription Agreements require the Company to obtain the investors prior consent, which is not to be unreasonably withheld, in order to offer, issue or sell any Company common stock or securities convertible into common stock in a private placement prior to February 7, 2012 for a price or exercise price that is less than $2.0625 per share.

In addition, the Company issued warrants entitling the investors in the private placement to acquire a total of 381,183 shares of common stock at an exercise price of $1.7675 per share. Each warrant has a three-year expiration date and is exercisable immediately. The exercise price of each warrant is subject to adjustment under certain circumstances; however, no adjustment to the exercise price will operate to reduce the exercise price to a price less than $1.70 per share.

During April 2011, the Company announced a rights offering (the Rights Offering) under which stockholders received one subscription right for each share of the Company s common stock owned on April 18, 2011, the record date for the Rights Offering. Each subscription right entitled the rights holder to purchase 0.15 newly issued shares of the Company s common stock at a subscription price of $2.0625 per share. The Rights Offering also included an over-subscription privilege and subscription rights under the Rights Offering were exercisable until May 13, 2011. The Company received gross proceeds of approximately $1.6 million under the Rights Offering, in addition to receiving approximately $0.4 million in purchases by a standby purchaser, in exchange for an aggregate of approximately 951,256 shares of common stock.

On November 29, 2011, the Company entered into a subscription agreement (Subscription Agreement) with BBS Capital Fund, L.P. (BBS). During December 2011, under the terms of the Subscription Agreement, BBS purchased 1,000,000 shares of the Company s stock during in exchange for an aggregate of $500,000 in cash in a private placement. As part of the transaction, the Company executed a Registration Rights Agreement, pursuant to which the Company agreed to register the resale of the shares of common stock issued to BBS. The managing member of BBS serves on the Company s Board of Directors.

At December 31, 2011, we had a net working capital deficit of approximately $2.9 million. Cash and cash equivalents at December 31, 2011 were approximately $0.6 million.

Due to uncertainty about our ability to meet our current operating expenses, debt obligations and capital expenditures, in their report on our annual financial statements for the year ended December 31, 2011, our independent registered public accounting firm included an explanatory paragraph regarding our ability to continue as a going concern. Our debt consists of $1.0 million of principal of the Director Notes as of December 31, 2011. The entire outstanding principal balance of the Director Notes, together with all accrued and unpaid interest, was originally due and payable on December 31, 2011. On December 30, 2011, we executed amendments to the Director Notes to extend the maturity date of the Director Notes to December 31, 2012.

The continuation of our business is dependent upon raising additional financial support. In light of our results of operations, management has and intends to continue to evaluate various possibilities. These possibilities include: raising additional capital through the issuance of common or preferred stock, securities convertible into common stock, or secured or unsecured debt, selling one or more lines of business, or all or a portion of the Company s assets, entering into a business combination, reducing or eliminating operations, liquidating assets, or seeking relief through a filing under the U.S. Bankruptcy Code. These possibilities, to the extent available, may be on terms that result in significant dilution to our existing stockholders or that would result in our stockholders losing all of their investment in the Company.

There can be no assurances that the Company will be successful in raising adequate additional financial support. If not, the Company will be required to reduce operations and/or liquidate assets and/or seek relief through a filing under the U.S. Bankruptcy Code. The Company s consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

Our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern. Our consolidated financial statements have been prepared assuming we will continue as a going concern. Our accumulated deficit amounts to approximately $107.8 million as of December 31, 2011.

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

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Cash Flows from Operating Activities: For the year ended December 31, 2011, we used approximately $3.5 million of cash in operating activities. The negative cash flow related to our net loss of approximately $4.4 million, adjusted for, among other things, certain non-cash items including approximately $0.6 million of depreciation, $1.3 million of stock-based compensation, $0.1 million in non-cash severance charges, as well as an aggregate decrease in cash flows from our operating assets and liabilities of approximately $1.0 million.

Cash Flows from Investing Activities: For the year ended December 31, 2011, we used less than $0.1 million of cash in investing activities. The cash usage was due to capital expenditures, primarily computer equipment purchases, purchased software and software development.

Cash Flows from Financing Activities: For the year ended December 31, 2011 our financing activities provided for approximately $3.7 million of cash. We received approximately $2.1 million from the issuance of common stock under a private placement. We received approximately $2.0 million from the issuance of common stock under a registered direct offering and a rights offering. Common stock issuance costs for 2011 were approximately $0.4 million.

Inflation

The impact of inflation on our operations has not been significant to date.

Off-Balance Sheet Arrangements

We are not involved in any off-balance sheet arrangements.

Revenue and Related Expense Recognition

Subscription 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, various portions of these fees are recognized ratably over the period services are being provided. 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 relating to our digital plans are expected to be recognized over the next fiscal quarter or within the next year. Subscriptions to our digital plans are recognized as revenue on a straight-line basis over the period of the digital plan subscription. Meal delivery revenue is recognized when our product is shipped from a fulfillment center and delivered to the end-customer.

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CRITICAL ACCOUNTING POLICIES

We have identified the policies outlined below as critical to our business operations and an understanding of our results of operations. Critical accounting policies and estimates are defined as those that are reflective of significant judgments and uncertainties, are the most pervasive and important to the presentation of our financial condition and results of operations and could potentially result in materially different results under different assumptions, judgments or conditions. Management has reviewed these critical accounting policies and estimates with the Audit Committee of our Board.

The listing is not intended to be a comprehensive list of all of our accounting policies. For a detailed discussion on the application of these and other accounting policies, see Note 2, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements, of this Annual Report on Form 10-K. 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. 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. Management bases these significant judgments and estimates on historical experience and other assumptions it believes to be reasonable based upon information presently available. There can be no assurance that actual results will not differ from those estimates.

REVENUE RECOGNITION:

Digital plan revenue is generated by our membership subscriptions to the proprietary content contained in our websites. Subscriptions to our digital plans are paid in advance, mainly via credit/debit cards, and cash receipts are deferred and recognized as revenue on a straight-line basis over the period of the digital plan subscription. Beginning in January 2008, the Company began to offer a guarantee to all customers, under which if a customer did not meet their weight loss goal upon completion of consecutive six months of digital subscription and met the guarantee requirements they would receive the next six months of digital subscription for free. We recognize digital subscription revenue over the potential term of twelve months of digital subscription or until the subscriber no longer meets the guarantee requirements, whichever comes first.

In accordance with ASC 605-45 (formerly Emerging Issues Task Force (EITF) 99-19), *Revenue Recognition Principal Agent Considerations,* we recognize gross digital 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.

Meal delivery revenue is recognized when the earnings process is complete, which is upon transfer of title of the product. This transfer occurs upon shipment from our fulfillment center to the end-customer. Meal delivery revenue includes amounts billed for shipping. In accordance with ASC 605-45, we recognize gross meal delivery revenues based on the relevant fact we are the primary obligor and have assumed asset risk when the customers place orders. Beginning in January 2008, we began offering two free offer promotions: a) buy seven weeks of meal delivery and get the 8^{th} week for free and b) buy a meal delivery program and get a free non-cash gift. For the first promotion and in accordance with ASC 605-50 (formerly EITF 01-09), *Revenue Recognition Customer Payments and Incentives*, we recognize the cost of the free offer as cost of revenue proportionally over the term of the meal delivery subscription or until the customer cancels and no longer is entitled to the free offer. During 2011, we began offering various free offer promotions whereby we recognize the cost of the free offer as cost of revenue proportionally over the term of the meal delivery subscription or until the customer cancels and is no longer entitled to the free offer. For the second promotion and in accordance with ASC 605-50, we recognize meal delivery revenue when the meals are shipped and the cost of the free non-cash gift as cost of sales when the non-cash gift is shipped.

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Business-to-business revenue relates to our Nutrio subsidiary, also known as eDiets Corporate Services. eDiets Corporate Services generates three types of business-to-business revenue. Licensing and development revenues are accounted for in accordance with Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements* (amendments to FASB ASC 605, *Revenue Recognition*). Development revenue relates to the planning, design and development of websites for customers. Both licensing and development revenues are recognized on a straight line basis over the license period once the website is launched. Consulting revenue relates to consulting services provided to customers and revenue is recognized when services and/or deliverables are completed and collection is probable.

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 our website view an advertisement. Amounts received or billed for which impressions have not yet been delivered are reflected as deferred revenue.

Ecommerce revenue is currently derived from the sale of the Company s various health and fitness store products, including vitamin supplements, to consumers. The Company offers an unconditional 30-day guarantee on all of its products. In accordance with ASC 605-15-25-1 (formerly Statement of Financial Accounting Standards (SFAS) 48), *Revenue Recognition Products*, the Company recognizes revenue on those products only when the guarantee period lapses.

Royalty revenue is derived from the exclusive technology licensing agreement related to our previous operations in the United Kingdom and Ireland and is being recognized on a straight-line basis. On July 31, 2009 the Company terminated the 15-year exclusive licensing agreement with Tesco Ireland Limited (Tesco) which provided Tesco with exclusive rights to use the Company s personalized diet technology in the United Kingdom and Ireland, with an effective date of July 1, 2009. The termination agreement provides Tesco with certain continuing rights in the Company technology used by or incorporated into Tesco s diet website prior to termination, including a three-year non-exclusive right to use such technology and, thereafter, an assignment of certain intellectual property rights relating to such technology.

Our most significant accounting estimate is our reserve for refunds for digital plans and meal delivery. Since digital plan subscriber payments are deferred upon receipt, at the end of each month we reclassify a portion of our deferred revenue to reserve for refunds. Based on historical experience, a range of between approximately 1%-3% of digital plan subscriber sales will result in a refund issued in the subsequent month after sale. All other refunds issued relate to current month digital plan subscriber sales. Because the revenue has not been recognized, refunds do not result in a reversal of digital plan subscription revenue. Instead, refunds result in a decrease to the amounts maintained in deferred revenue. Meal delivery refunds mainly result from late shipments or packaging issues. Based on historical experience, a range of between approximately 1%-3% of prior month s meal delivery sales will result in a refund, accordingly we estimate a reserve based on that assumption for future refunds. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate the reserve for refunds. However, if actual results are not consistent with our estimates or