HOMEAWAY INC
Form 10-Q
November 07, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

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: 001-35215

HomeAway, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-0970381**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1011 W. Fifth Street, Suite 300

Austin, Texas 78703

(Address of principal executive offices, including zip code)

(512) 684-1100

(Registrant s telephone number, including area code)

Indicate by check mark whether 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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). x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of stock, as of the latest practicable date.

Class	Outstanding at October 31, 2012
Common Stock, $0.0001 par value per share	**83,094,113**

Table of Contents

HomeAway, Inc.

Table of Contents

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

HomeAway, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except for share and per share information)

(unaudited)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 160,937	$ 118,208
Short-term investments	83,272	65,748
Accounts receivable, net of allowance for doubtful accounts of $622 and $425 as of September 30, 2012 and December 31, 2011, respectively	16,272	15,929
Income tax receivable	21	
Prepaid expenses and other current assets	6,495	5,680
Restricted cash	280	1,039
Deferred tax assets	4,075	4,090
Total current assets	271,352	210,694
Property and equipment, net	32,716	25,865
Goodwill	310,618	301,015
Intangible assets, net	62,660	61,515
Restricted cash	240	244
Deferred tax assets	4,013	1,794
Other non-current assets	15,490	3,504
Total assets	$ 697,089	$ 604,631
Liabilities, preferred stock and stockholders equity		
Current liabilities:		
Accounts payable	$ 4,978	$ 3,102
Income tax payable	6,972	6,283
Accrued expenses	29,986	26,931
Deferred revenue	125,147	101,955
Deferred tax liabilities	85	92
Total current liabilities	167,168	138,363
Deferred revenue, less current portion	2,380	2,608
Deferred tax liabilities	17,892	16,224
Other non-current liabilities	9,449	6,427
Total liabilities	196,889	163,622
Commitments and contingencies (Note 6)		
Preferred stock		

$0.0001 par value per share; 10,000,000 shares authorized as of September 30, 2012 and December 31, 2011, respectively; zero shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively		
Stockholders equity		
Common stock: $0.0001 par value; 350,000,000 shares authorized; 82,989,924 and 80,685,391 shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively	8	8
Additional paid-in capital	607,551	558,667
Accumulated other comprehensive income (loss)	(6,585)	(6,480)
Accumulated deficit	(100,774)	(111,186)
Total stockholders equity	500,200	441,009
Total liabilities, preferred stock and stockholders equity	$ 697,089	$ 604,631

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

3

Table of Contents

HomeAway, Inc.

Condensed Consolidated Statements of Operations

(In thousands, except for per share information)

(unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenue:				
Listing	$ 61,392	$ 52,499	$ 175,601	$ 148,667
Other	11,736	8,621	33,246	23,101
Total revenue	73,128	61,120	208,847	171,768
Costs and expenses:				
Cost of revenue (exclusive of amortization shown separately below)	11,278	8,439	33,105	25,548
Product development	11,034	8,650	31,060	24,089
Sales and marketing	22,492	17,851	71,300	61,129
General and administrative	14,547	12,700	42,036	34,386
Amortization expense	3,298	3,053	9,028	8,853
Total costs and expenses	62,649	50,693	186,529	154,005
Operating income	10,479	10,427	22,318	17,763
Other income (expense):				
Interest income	275	124	684	240
Other income (expense)	109	(1,746)	(2,201)	(2,135)
Total other income (expense)	384	(1,622)	(1,517)	(1,895)
Income before income taxes	10,863	8,805	20,801	15,868
Income tax expense	(5,708)	(6,072)	(10,389)	(9,434)
Net income	5,155	2,733	10,412	6,434
Cumulative preferred stock dividends and discount accretion		(6,794)		(24,678)
Net income (loss) attributable to common stockholders	$ 5,155	$ (4,061)	$ 10,412	$ (18,244)
Net income (loss) per share attributable to common stockholders:				
Basic	$ 0.06	$ (0.05)	$ 0.13	$ (0.35)
Diluted	$ 0.06	$ (0.05)	$ 0.12	$ (0.35)
Weighted average number of shares outstanding:				
Basic	82,686	78,528	82,107	52,386
Diluted	85,043	78,528	84,811	52,386

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

Table of Contents

HomeAway, Inc.

Condensed Consolidated Statements of Comprehensive Income

(In thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 5,155	$ 2,733	$ 10,412	$ 6,434
Other comprehensive income:				
Foreign currency translation adjustments	1,757	(6,008)	(467)	(509)
Change in unrealized gains on short-term investments, net of tax	223	1	362	7
Total other comprehensive income, net of tax	1,980	(6,007)	(105)	(502)
Comprehensive income	$ 7,135	$ (3,274)	$ 10,307	$ 5,932

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

Table of Contents

HomeAway, Inc.

Consolidated Statement of Changes in Stockholders Equity

(In thousands)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders Equity
Balance at December 31, 2011	80,685	$ 8	$ 558,667	$ (6,480)	$ (111,186)	$ 441,009
Exercise of stock options	2,305		21,984			21,984
Stock compensation expenses			19,556			19,556
Excess tax benefits related to employee stock options			7,344			7,344
Other comprehensive income				(105)		(105)
Net income					10,412	10,412
Balance at September 30, 2012	82,990	$ 8	$ 607,551	$ (6,585)	$ (100,774)	$ 500,200

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

Table of Contents

HomeAway, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash flows from operating activities		
Net income	$ 10,412	$ 6,434
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,037	6,220
Amortization of intangible assets	9,028	8,853
Amortization of premiums on securities and other	1,827	29
Stock-based compensation	19,556	17,179
Excess tax benefit from stock-based compensation	(7,344)	(1,041)
Deferred income taxes	(3,726)	6,755
Loss on sale of investments and other		40
Net realized/unrealized foreign exchange (gain) loss	(43)	752
Realized loss on foreign currency forwards	1,910	1,642
Changes in operating assets and liabilities, net of assets and liabilities assumed in business combinations:		
Accounts receivable	235	(3,572)
Income tax receivable	75	(9,809)
Prepaid expenses and other current assets	(6,369)	(4,036)
Accounts payable	1,766	(1,720)
Accrued expenses	2,584	(73)
Income taxes payable	7,747	14,056
Deferred revenue	21,939	15,996
Deferred rent and other non-current liabilities	3,017	(234)
Net cash provided by operating activities	70,651	57,471
Cash flows from investing activities		
Cash paid for businesses acquired, net of cash acquired	(16,207)	(4,698)
Change in restricted cash	757	1,538
Cash paid for trademarks and other assets acquired	(243)	(262)
Cash paid for non-marketable equity investment	(6,446)	
Purchases of short-term investments	(47,392)	
Proceeds from maturities of marketable securities	28,418	10,035
Net settlement of foreign currency forwards	(1,910)	(1,642)
Purchases of property and equipment	(14,641)	(8,904)
Net cash used in investing activities	(57,664)	(3,933)
Cash flows from financing activities		
Proceeds from exercise of options to purchase common stock	21,984	2,737
Payments of dividends on preferred stock		(54,436)
Proceeds from initial public offering, net of underwriting discount and offering expenses		146,303
Payments for redemption of preferred stock		(43,451)
Excess tax benefit from stock-based compensation	7,344	1,041

Net cash provided by financing activities	29,328	52,194
Effect of exchange rate changes on cash	414	(1,186)
Net increase in cash and cash equivalents	42,729	104,546
Cash and cash equivalents at beginning of period	118,208	65,697
Cash and cash equivalents at end of period	$ 160,937	$ 170,243
Cash paid for taxes	$ 7,522	$ 2,785
Supplemental disclosure of noncash financing activities		
Conversion of preferred stock to common shares	$	$ 405,756

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

Table of Contents

HomeAway, Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

1. Description of Business

HomeAway, Inc., or the Company, operates an online vacation rental property marketplace that enables property owners and managers to market properties available for rental to vacation travelers who rely on the Company s websites to search for and find available properties. These owners and managers pay the Company to publish detailed property listings, including photographs, descriptions, location, pricing, availability and contact information. The Company sells complementary products as well, including travel guarantees and property management software and services. Travelers use the network of websites to search for vacation rentals that meet their desired criteria including location, size and price. Travelers that find properties that meet their requirements through the Company s marketplace are able to contact owners and managers directly by phone or through form-based communication tools on the Company s websites.

The Company is a Delaware corporation headquartered in Austin, Texas.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of HomeAway, Inc. and all of its wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission, or the SEC. All significant intercompany transactions and balances have been eliminated in consolidation. In the opinion of the Company s management, the accompanying interim unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of normal recurring adjustments and those items discussed in these Notes, necessary for a fair presentation of the Company s financial position, as of September 30, 2012, the results of operations for the three and nine months ended September 30, 2012 and 2011, the statements of comprehensive income for the three and nine months ended September 30, 2012 and 2011, the cash flows for the nine months ended September 30, 2012 and 2011 and stockholders equity for the nine months ended September 30, 2012. Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the accompanying Notes for the fiscal year ended December 31, 2011. Operating results for this interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or for any other period.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. These differences could have a material effect on the Company s future results of operations and financial position. Significant items subject to those estimates and assumptions include certain revenue, allowance for doubtful accounts, fair value of investments, carrying amounts of goodwill and other indefinite lived intangible assets, depreciation and amortization, valuation of stock options and deferred income taxes.

Fair Value of Financial Instruments

The authoritative guidance on fair value measurements for financial assets and liabilities establishes a three-tiered fair value hierarchy that prioritizes inputs to valuation techniques used in fair value calculations. The three levels of inputs are defined as follows:

Level 1: Unadjusted quoted prices for identical assets or liabilities in active markets accessible by the Company.

Level 2: Inputs that are observable in the marketplace other than those inputs classified as Level 1.

Level 3: Inputs that are unobservable in the marketplace and significant to the valuation.

The following section describes the valuation methodologies used to measure different financial assets and financial liabilities at fair value.

Table of Contents

Money Market Funds and Short-Term Investments

In order to determine fair value of the Company s money market funds and short-term investments, quoted prices in active markets for identical assets are used. Therefore, the Company s money market funds and short-term investments are considered Level 1 items. At September 30, 2012 and December 31, 2011, the Company did not have any financial instruments that qualified as Level 2 or 3 items.

Short-term investments include mutual fund securities, corporate bonds, U.S. government agency bonds and municipal bonds and are classified as available for sale and reported at fair value using the specific identification method. Unrealized gains and losses are excluded from earnings and reported as a component of other comprehensive income (loss), net of related estimated tax provisions or benefits. Additionally, the Company periodically assesses whether an other than temporary impairment loss on investments has occurred due to declines in fair value or other market conditions. Declines in fair value that are considered other than temporary are recorded as an impairment of investments in the consolidated statement of operations. The Company did not record any impairments of its investments for any of the periods presented.

The carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued liabilities and deferred revenue approximate fair value at September 30, 2012 and December 31, 2011, respectively, because of the relatively short maturity of these instruments.

The following table summarizes the basis used to measure certain financial assets and liabilities at fair value on a recurring basis in the Company s consolidated balance sheets at September 30, 2012 and December 31, 2011 (in thousands):

	Balance as of September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents				
Money market funds	$ 72,376	$ 72,376	$	$
Total cash equivalents	72,376	72,376		
Restricted Cash				
Money market funds	520	520		
Total restricted cash	520	520		
Short-term investments				
Mutual fund securities	1	1		
Corporate bonds	69,324	69,324		
U.S. government agency bonds	1,016	1,016		
Municipal bonds	12,931	12,931		
Total short-term investments	83,272	83,272		
Total financial assets	$ 156,168	$ 156,168	$	$

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Assets								
Cash equivalents								
Money market funds	$	37,390	$	37,390	$		$	
Total cash equivalents		37,390		37,390				
Restricted Cash								
Money market funds		1,283		1,283				
Total restricted cash		1,283		1,283				
Short-term investments								
Mutual fund securities		62		62				
Corporate bonds		45,768		45,768				
U.S. government agency bonds		3,000		3,000				
Municipal bonds		16,918		16,918				
Total short-term investments		65,748		65,748				
Total financial assets	$	104,421	$	104,421	$		$	

Table of Contents

Business Segment

The Company has one operating and reporting segment consisting of various products and services that are all related to its online marketplace of rental listing websites. The Company s chief operating decision maker is considered to be the Chief Executive Officer. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the single reporting segment level.

Cash and Cash Equivalents

Cash and cash equivalents include investments in money market funds and certificates of deposit that are readily convertible into cash. Cash and cash equivalents are stated at cost, which approximates fair value. The Company considers all highly liquid investments purchased with an original maturity date of three months or less to be cash equivalents.

Investments

Short-term Investments

Short-term investments generally consist of marketable securities that have remaining maturities of less than one year from the respective balance sheet dates. Investments in which the Company has the ability and intent, if necessary, to liquidate in order to support its current operations (including those with contractual maturities greater than one year from the date of purchase) are classified as short-term. The Company s investment securities are classified as available-for-sale and are presented at estimated fair value with any unrealized gains and losses included in other comprehensive income (loss). Cash flows from purchases, sales and maturities of available-for-sale securities are classified as cash flows from investing activities and reported gross, including any related premiums or discounts. Premiums related to purchases of available-for-sale securities were $2,219,000 for the nine months ended September 30, 2012. Fair values are based on quoted market prices. Short-term investments consisted of the following at September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012			
	Gross Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mutual fund securities	$ 1	$	$	$ 1
Corporate bonds	69,166	174	(16)	69,324
U.S. government agency bonds	1,014	2		1,016
Municipal bonds	12,912	20	(1)	12,931
Total short-term investments	$ 83,093	$ 196	$ (17)	$ 83,272

	December 31, 2011			
	Gross Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mutual fund securities	$ 48	$ 14	$	$ 62
Corporate bonds	45,954	13	(199)	45,768
U.S. government agency bonds	3,000			3,000
Municipal bonds	16,929	1	(12)	16,918
Total short-term investments	$ 65,931	$ 28	$ (211)	$ 65,748

The mutual fund securities do not have contractual maturities. All of the $1,016,000 invested in U.S. government agency bonds at September 30, 2012 have remaining contractual maturities shorter than one year. All of the $3,000,000 invested in U.S. government agency bonds at December 31, 2011 have remaining contractual maturities longer than one year. Of the amounts invested in corporate bonds at September 30, 2012 and December 31, 2011, $30,416,000 and $26,304,000 have remaining contractual maturities longer than one year, and $38,908,000 and $19,464,000 have remaining contractual maturities within one year, respectively. Of the amounts invested in municipal bonds at September 30, 2012 and December 31, 2011, $3,593,000 and $5,469,000 have remaining contractual maturities longer than one year, and $9,338,000 and $11,449,000 have remaining contractual maturities within one year, respectively.

Non-marketable Equity Investment

During the nine months ended September 30, 2012, the Company invested $6,446,000 for a non-controlling equity investment in a privately-held company. The Company s investment in the privately-held company is reported at cost using the cost method of accounting or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. No event or circumstance indicating an other-than-temporary decline in value of the Company s interest in the non-marketable equity investment was identified.

As of September 30, 2012, the carrying value of the Company s investment in the privately-held company was $6,446,000. This investment is recorded in other non-current assets on the consolidated balance sheets.

Accounts Receivable

Accounts receivable are primarily generated from three sources. Amounts due from credit card merchants who process the Company s credit card sales from property listings and remit the proceeds to the Company are the primary source of accounts receivable. Accounts receivables are also generated from Internet display advertising amounts due in the ordinary course of business as well as amounts due to the Company for property listings or other products purchased on account. Accounts receivable from Internet display advertising revenue and products purchased on account are recorded at the invoiced amount and are non-interest bearing. Accounts receivable outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by estimating losses on receivables based on known troubled accounts and historical experience of losses incurred.

Property and Equipment

Property and equipment are recorded at cost. Ordinary maintenance and repairs are charged to expense, while expenditures that extend the physical or economic life of the assets are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Equipment, computer hardware and purchased computer software are depreciated over three years. Furniture and fixtures are depreciated over five to ten years. Leasehold improvements are depreciated on a straight-line basis over the shorter of the contractual lease period or their useful life. Upon disposal, property and equipment and the related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in the statements of operations.

The Company capitalizes certain internally developed software costs in accordance with authoritative guidance. These capitalized costs were approximately $22,538,000 and $18,364,000 at September 30, 2012 and December 31, 2011, respectively, and are included in property and equipment, net, in the balance sheet with depreciation expense in the three months ended September 30, 2012 and 2011 of approximately $888,000 and $428,000, respectively and depreciation expense in the nine months ended September 30, 2012 and 2011 of approximately $2,273,000 and $1,777,000, respectively. The internally developed software costs are depreciated over five years.

Goodwill and Intangible Assets

Goodwill arises from business combinations and is measured as the excess of the cost of the business acquired over the sum of the acquisition-date fair values of tangible and identifiable intangible assets acquired, less any liabilities assumed.

Tests for impairment of goodwill are performed on an annual basis, or at any other time, if events occur or circumstances indicate that the carrying amount of goodwill may not be recoverable. The Company annually evaluates goodwill for impairment as of October 1.

Under new accounting guidance adopted for fiscal 2011, the Company evaluates qualitative factors (including macroeconomic conditions, industry and market considerations, cost factors, and overall financial performance) to determine whether it is necessary to perform the first step of the two-step goodwill test. This step is referred to as the Step 0 analysis . If it is determined that it is more likely than not (a likelihood of more than 50% impairment) that the fair value of a reporting unit is less than its carrying amount, then the entity will need to proceed to the first step (Step One) of the two-step goodwill test. In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, relevant events and circumstances as discussed above shall be assessed. If, after assessing the totality of events or circumstances, an entity determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then the first and second steps of the impairment test are unnecessary.

Circumstances that could trigger an impairment test outside of the annual test include but are not limited to: a significant adverse change in the business climate or legal factors; adverse cash flow trends; an adverse action or assessment by a regulator; unanticipated competition; loss of key personnel; decline in stock price; and results of testing for recoverability of a significant asset group within a reporting unit. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment

11

loss is recorded. As of October 1, 2011, the Company evaluated goodwill using a Step 0 analysis and determined that it was more likely than not (a likelihood of more than 50% impairment) that the fair value of our sole reporting unit exceeded its carrying amount by a substantial margin and consequently did not proceed to Step One of the test. The Company determined that no triggering event occurred in any of the periods presented.

Identifiable intangible assets consist of acquired trade names, customer listings, technology, domain names and contractual non-compete agreements associated with acquired businesses. In assessing the fair value of indefinite lived intangible assets, a relief from royalty methodology and a discounted cash flow methodology were used.

The determination of whether or not goodwill or indefinite lived intangible assets have become impaired involves a significant level of judgment in the assumptions underlying the approach used to determine the value of the reporting unit or intangible assets. Changes in the Company s strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded amounts of goodwill or intangible assets.

No impairment of goodwill or indefinite-lived intangible assets was identified in any of the periods presented.

Intangible assets with definite lives are amortized over their estimated useful lives on a straight-line basis and reviewed for impairment whenever events or changes in circumstances indicate that an asset s carrying value may not be recoverable (see Note 4). The straight-line method of amortization represents the Company s best estimate of the distribution of the economic value of the identifiable intangible assets.

Impairment of Long-lived Assets

The Company evaluates long-lived assets, such as property and equipment, for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated future undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value in the period in which the determination is made. No impairments of long-lived assets have been recorded during any of the periods presented.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an agreement exists, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured.

The Company generates substantially all its revenue from customers that pay fees for online advertising listing services related to the listing of their properties for rent, primarily on a subscription basis, over a fixed-term. The Company also generates revenue from fees based on the number of traveler inquiries and reservation bookings, local and national Internet display advertisers, license of property management software and ancillary products and services.

Payments for term-based subscriptions received in advance of services being rendered are recorded as deferred revenue and recognized ratably on a straight-line basis over the listing period. Revenue for inquiry-based contracts are determined on a fixed fee-per-inquiry stated in the arrangement and recognized when the service has been performed.

Internet display advertising revenue is generated primarily from advertisements appearing on the Company s websites. There are several types of Internet advertisements, and the way in which advertising revenue is earned varies among them. Depending upon the terms, revenue might be earned each time an impression is delivered, each time a user clicks on an ad, each time a graphic ad is displayed, or each time a user clicks-through on the ad and takes a specified action on the destination site. The Company recognizes advertising revenue on a cost-per-thousand (CPM) impression basis whereby advertisers pay the Company based on the number of times their ads appear on the Company s websites.

The Company sells gift cards with no expiration dates to travelers and does not charge administrative fees on unused cards. There is a portion of the gift card obligation that, based on historical redemption patterns, will never be used or required to be remitted to relevant jurisdictions, or breakage. At the point of sale, the Company recognizes breakage as deferred income and amortizes that over 48 months based on historical redemption patterns. The Company also records commission revenue for each gift card sale over the same 48-month redemption period.

The Company earns a commission for online reservations revenue calculated as a percentage of the value of the reservation. This revenue is included in other revenue in the consolidated statement of operations.

Table of Contents

Through its professional software for bed and breakfasts and professional property managers, the Company makes selected, online bookable properties available to online travel agencies and channel partners. The Company receives a percentage of the transaction value or a fee from the property manager for making this inventory available, which is recognized when earned. This revenue is included in other revenue in our consolidated statement of operations.

The Company generates revenue from the licensing of software products, from the sale of maintenance agreements and from the sale of hosted software solutions. For software license sales, typically one year of maintenance is included as part of the initial purchase price of the bundled offering with annual renewals of the maintenance component of the agreement following in subsequent years.

The Company considers delivery of its software to have occurred and recognizes revenue from the sale of perpetual licenses when risk of loss transfers to the customer, which is generally upon electronic transfer of the license key that provides immediate availability of the product to the purchaser.

As software is usually sold with maintenance, the amount of revenue allocated to the software license is determined by allocating the fair value of the maintenance and subtracting it from the total invoice or contract amount. Vendor-specific objective evidence, or VSOE, of the fair value of maintenance services is determined by the standard published list pricing for maintenance renewals, as the Company generally charges list prices for maintenance renewals. In determining VSOE, the Company requires that a substantial majority of the selling price for maintenance services fall within a reasonably narrow pricing range. Maintenance and support revenue is recognized ratably over the term of the agreement beginning on the activation date. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Sales of hosted software solutions are generally for a one-year period. Revenues are recognized on a straight-line basis over the contract term. Certain implementation services related to the hosting services are essential to the customer s use of the hosting services. For sales of these hosting services where the Company is responsible for implementation, the Company recognizes implementation revenue ratably over the estimated period of the hosting relationship, which the Company considers to be three years. Recognition starts once the product has been activated.

Training and consulting revenue is recognized upon delivery of the training course or consulting services to the end customer.

The Company accounts for sales incentives to customers as a reduction of revenue at the time that the revenue is recognized from the related product sale. The Company also reports revenue net of any sales tax collected.

Stock-Based Compensation

The cost of stock-based transactions is recognized in the financial statements based upon the fair value of the Company s common stock on the date of grant. The fair value of restricted stock awards is determined based on the number of shares granted and the fair value of the Company s common stock as of the grant date. The fair value of stock options is determined as of the grant date using the Black Scholes valuation model. Fair value is generally recognized as an expense on a straight-line basis, net of estimated forfeitures, over the employee requisite service period. Accordingly, stock-based compensation for the three and nine months ended September 30, 2012 and 2011 has been reduced for estimated forfeitures. When estimating forfeitures, the Company considers voluntary termination behaviors as well as trends of actual option forfeitures.

The Company uses the with and without approach in determining the order in which tax attributes are utilized. As a result, the Company only recognizes a tax benefit from stock-based awards in additional paid-in capital if an incremental tax benefit is realized after all other tax attributes currently available to the Company have been utilized. When tax deductions from stock-based awards are less than the cumulative book compensation expense, the tax effect of the resulting difference (shortfall) is charged first to additional paid-in capital to the extent of the Company s pool of windfall tax benefits with any remainder recognized in income tax expense. The Company has determined that it has a sufficient windfall pool available and therefore no amounts have been recognized in income tax expense. In addition, the Company accounts for the indirect effects of stock-based awards on other tax attributes through the consolidated statements of operations.

The benefits of tax deductions in excess of recognized compensation costs are reported as financing cash flows, but only when such excess tax benefits are realized by a reduction to current taxes payable. The Company recognized a tax benefit of approximately $4,814,000 and $700,000 during the three months ended September 30, 2012 and 2011, respectively, from the exercise of stock options and $7,344,000 and $1,041,000 during the nine months ended September 30, 2012 and 2011, respectively. This tax benefit has been recorded as additional paid-in capital on the Company s consolidated balance sheets as of September 30, 2012 and December 31, 2011.

Table of Contents

Income Taxes

The Company recognizes income taxes using an asset and liability approach. This approach requires the recognition of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company s consolidated financial statements or tax returns. The measurement of deferred taxes is based on provisions of the enacted tax law and the effects of future changes in tax laws or rates are not anticipated.

A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Evaluating the need for an amount of a valuation allowance for deferred tax assets requires judgment and analysis of all the positive and negative evidence available to determine whether all or some portion of the deferred tax assets will not be realized. Based on the available evidence and judgment, the Company has determined that it is more likely than not that certain loss carryforwards will not be realized; therefore, the Company has established a valuation allowance for such deferred tax assets to reduce the loss carryforward assets to amounts expected to be utilized.

The Company may be subject to income tax audits by the respective tax authorities in any or all of the jurisdictions in which the Company operates. During the second quarter of 2012, an audit at one of the Company s subsidiaries in France was completed, which did not result in material adjustments to the consolidated financial statements. The Company is currently undergoing an audit at one of its subsidiaries in Germany. The Company recognizes the benefit of uncertain income tax positions only if these positions are more likely than not to be sustained. Also, the recognized income tax benefit is measured at the largest amount that is more than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits as a component of income tax expense. The countries in which the Company may be subject to potential examination by tax authorities include the United States, Switzerland, the United Kingdom, Germany, France, Spain, the Netherlands, Brazil, and Australia.

The calculation of the Company s tax liabilities involves the inherent uncertainty associated with the application of complex tax laws. As a multinational corporation, the Company conducts its business in many countries and is subject to taxation in many jurisdictions. The taxation of the Company s business is subject to the application of various and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The Company s effective tax rate is highly dependent upon the geographic distribution of its worldwide earnings or losses, the tax regulations and tax rates in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of its tax planning strategies. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation, and the evolution of regulations and court rulings. Consequently, taxing authorities may impose tax assessments or judgments against the Company that could materially impact its tax liability and/or its effective income tax rate. The Company believes it has adequately provided in its financial statements for additional taxes that it estimates may be assessed by the various taxing authorities. While the Company believes that it has adequately provided for all uncertain tax positions, amounts asserted by tax authorities could be greater or less than the Company s accrued position. These tax liabilities, including the interest and penalties, are adjusted pursuant to a settlement with tax authorities, completion of audit or expiration of various statutes of limitation.

Foreign Currency Translation

The functional currency of the Company s foreign subsidiaries is generally their respective local currency. The financial statements of the Company s international operations are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders equity, and a weighted average exchange rate for each period for revenues, expenses, and gains and losses. Foreign currency translation adjustments are recorded as a separate component of stockholders equity. Gains and losses from foreign currency denominated transactions are recorded in other income in the Company s consolidated statements of operations. For the three months ended September 30, 2012 and 2011, the Company recorded transaction gains of approximately $8,000 and transaction losses of approximately $1,725,000, respectively. For the nine months ended September 30, 2012 and 2011, the Company recorded transaction losses of approximately $2,285,000 and $2,160,000, respectively.

Derivative Financial Instruments

As a result of the Company s international operations, it is exposed to various market risks that may affect its consolidated results of operations, cash flows and financial position. These market risks include, but are not limited to, fluctuations in currency exchange rates. The Company s primary foreign currency exposures are in Euros and British Pound Sterling, in which it conducts a significant portion of business activities. As a result, the Company faces exposure to adverse movements in currency exchange rates as the financial results of its operations are translated from local currency into U.S. dollars upon consolidation. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in gains and losses that are reflected in income.

The Company may enter into derivative instruments to hedge certain net exposures of nonfunctional currency denominated assets and liabilities, primarily related to intercompany loans, even though it does not elect to apply hedge accounting or hedge accounting does not apply. Gains and losses resulting from a change in fair value for these derivatives are reflected in income in the period in which the change occurs and are recognized on the consolidated statement of operations in other income (expense). Cash flows from these contracts are classified within net cash provided by operating activities on the consolidated statements of cash flows.

The Company does not use financial instruments for trading or speculative purposes. The Company recognizes all derivative instruments on the balance sheet at fair value and its derivative instruments are generally short-term in duration. Derivative contracts were not material as of September 30, 2012, and no derivative contracts were outstanding as of December 31, 2011. The Company is exposed to the risk that counterparties to derivative contracts may fail to meet their contractual obligations.

Net Income (Loss) Per Share

Basic income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding during the period. Net income (loss) attributable to common stockholders is reduced (increased) by cumulative preferred stock dividends earned and accretion of preferred stock to redemption values during the period. Diluted income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders by the weighted average common shares outstanding plus potentially dilutive common shares.

Restricted stock awards provide the holder of unvested shares the right to participate in dividends declared on the Company s common stock. Accordingly, these shares are included in the weighted average shares outstanding for the computation of basic earnings per share in periods of undistributed earnings. Restricted stock awards are excluded from the basic earnings per share in periods of undistributed losses as the holders are not contractually obligated to participate in the losses of the Company.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss), cumulative foreign currency translation adjustments, and unrealized gains and losses on available-for-sale securities.

Recently Issued Accounting Standards

In 2012, the Financial Accounting Standards Board (FASB) issued a new accounting standard that simplifies the impairment test for indefinite-lived intangible assets other than goodwill. The new guidance gives the option to first assess qualitative factors to determine if it is more likely that not that the fair value of an indefinite-lived intangible asset is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative valuation test. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after September 15, 2012. The Company will adopt this accounting standard in the fourth quarter of 2012 and does not anticipate that this adoption will have a significant impact on our financial position, results of operations or cash flows.

3. Business Combinations

The following table summarizes the Company s acquisition during the period ended September 30, 2012 with amounts shown below as fair values at the acquisition date (in thousands):

	Toprural
Net tangible assets (liabilities) acquired	
Cash	$ 3,220
Deferred revenue	(2,269)
Other	(315)
Total tangible assets (liabilities) acquired	636
Deferred tax liabilities	(3,295)
Trade name	1,060
Developed technology	2,144

Customer relationships	7,440
Goodwill	11,292
Aggregate purchase price	$ 19,277

Table of Contents

Tangible net assets were valued at their respective carrying amounts, which the Company believes approximate their current fair values at the respective acquisition dates.

The valuation of identifiable intangible assets acquired reflects management s estimates based on, among other factors, use of established valuation methods. Identifiable intangible assets with definite lives are amortized over the period of estimated benefit using the straight-line method and the estimated useful lives of four to 10 years. The straight-line method of amortization represents the Company s best estimate of the distribution of the economic value of the identifiable intangible assets. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired.

Toprural

In April 2012, the Company acquired 100% of the outstanding stock of Top Rural S.L., the leading site for independently-owned rural accommodations in Southern Europe (the acquired business is referred to as Toprural), for cash consideration of approximately $19,277,000. The acquisition of Toprural further solidifies the Company s market presence in Spain and Southern Europe and extends the Company s reach to a desirable European traveler segment that seeks long weekend holidays to small towns or countryside destinations.

Approximately $2,670,000 of the cash consideration purchase price was deposited in escrow as security for the benefit of the Company against breaches of representations and warranties, covenants and certain other expressly enumerated matters by the sellers. The escrow funds not used to satisfy such seller obligations will be released to the sellers in two equal payments on the first and second anniversary dates of the acquisition.

The acquired goodwill primarily represents synergies associated with adding Toprural to the Company s marketplace of websites to provide travelers with a broader inventory selection of vacation properties to choose from. Goodwill is not deductible for tax purposes. The trade name has a useful life of 10.0 years from the date of acquisition, the developed technology has a useful life of 4.0 years from the date of acquisition and the customer relationships have a useful life of 8.0 years from the date of acquisition.

The results of Toprural have been included in the Company s consolidated results since the acquisition date in April 2012. Proforma results of operations related to this acquisition have not been presented since Toprural s operating results up to the date of acquisition were not material to the Company s consolidated financial statements.

4. Goodwill and Other Intangible Assets

Goodwill

Changes in the Company s goodwill balance for the year ended December 31, 2011 and the period ended September 30, 2012 are summarized in the table below (in thousands):

Balance at December 31, 2010	$ 300,780
Acquired in business combinations	2,114
Foreign currency translation adjustment	(1,879)
Balance at December 31, 2011	301,015
Acquired in business combinations	11,292
Foreign currency translation adjustment	(1,689)
Balance at September 30, 2012	$ 310,618

Intangible Assets

The Company s intangible assets, excluding goodwill, consist of intangible assets acquired primarily in business combinations and were recorded at their estimated fair values on the date of acquisition. The finite-lived intangible assets that are being amortized are summarized in the table below (in thousands):

		September 30, 2012			December 31, 2011		
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trade names and trademarks	10	$ 23,778	$ (1,837)	$ 21,941	$ 1,154	$ (778)	$ 376
Developed technology	2-8	26,243	(20,129)	6,114	24,186	(18,483)	5,703
Customer relationships	6-13	59,938	(32,972)	26,966	52,912	(27,393)	25,519
Noncompete agreements and domain names	2-5	3,376	(2,766)	610	3,363	(2,345)	1,018
Total		$ 113,335	$ (57,704)	$ 55,631	$ 81,615	$ (48,999)	$ 32,616

Amortization of non-compete agreements is recorded over the term of the agreements.

Amortization expense for the three months ended September 30, 2012 and 2011 was approximately $3,298,000 and $3,053,000, respectively. Amortization expense for the nine months ended September 30, 2012 and 2011 was approximately $9,028,000 and $8,853,000, respectively.

The Company has the following indefinite-lived intangible assets recorded in its consolidated balance sheet as of September 30, 2012 and December 31, 2011, respectively (in thousands):

	September 30, 2012	December 31, 2011
Trademarks, trade names and other	$ 7,029	$ 28,899

The Company performs annual impairment testing of intangibles with indefinite lives or whenever events or circumstances indicate that impairment may have occurred. Due to website network and brand consolidation efforts, the Company began amortizing certain indefinite lived intangible assets during the nine months ended September 30, 2012, over a 10 year useful life. This change in estimate resulted in increased amortization expense of $1,224,000 during the nine months ended September 30, 2012.

5. Accrued Expenses

The Company s accrued expenses are comprised of the following at September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012	December 31, 2011
Compensation and related benefits	$ 12,847	$ 12,016
Gift cards	4,594	5,679
Taxes	2,547	1,983
Other	9,998	7,253
Total	$ 29,986	$ 26,931

6. Commitments and Contingencies

Leases

The Company leases its facilities and certain office equipment under non-cancellable operating leases. Rental expense was approximately $1,151,000 and $1,208,000 for the three months ended September 30, 2012 and 2011, respectively, and $3,278,000 and $3,250,000 for the nine months ended September 30, 2012 and 2011, respectively.

Guarantees

The Company offers two guarantee products to travelers: Basic Rental Guarantee and Carefree Rental Guarantee. The Basic Rental Guarantee is offered to travelers that book a vacation rental property listed on any one of the Company s websites to protect 50% of their vacation rental payments up to $1,000 against Internet fraud. Travelers also may purchase additional protection to cover 100% of vacation rental payments up to $10,000 against Internet fraud, misrepresentation, wrongful denial of entry, wrongful deposit loss or, beginning in 2012, losses from phishing claims by the purchase of the Carefree Rental Guarantee. The Company does not maintain insurance from any third party against claims under the guarantees, and any amounts payable for claims made under these guarantees are payable by the Company. Amounts recorded for estimated future claims under the guarantees are based on historical experience and estimates of potential future claims made by the Company are recorded either in cost of revenue or in general and administrative expense in the Company s consolidated statement of operations depending on whether the expense is related to the Basic Rental Guarantee or to the Carefree Rental Guarantee. At September 30, 2012 and December 31, 2011, the Company had recorded approximately $573,000 and $247,000, respectively, as an accrued expense for potential future claims.

Changes for the traveler guarantees, which are presented as a current liability in the Company s consolidated balance sheets, for the period ended September 30, 2012 and December 31, 2011 are summarized in the table below (in thousands):

Balance at December 31, 2010	$ 232
Costs accrued for new rentals	175
Release of expected guarantee	
Guarantee obligations honored	(160)
Balance at December 31, 2011	247
Costs accrued for new rentals	767
Release of expected guarantee	
Guarantee obligations honored	(441)
Balance at September 30, 2012	$ 573

17

Table of Contents

The Company maintains a guarantee of £5,000,000 (approximately $8,084,500 as of September 30, 2012) in favor of a bank in the United Kingdom for extending credit to the Company in connection with the wholly owned United Kingdom subsidiary s business of collecting its subscription revenues in advance via credit card payments.

Legal

From time to time, the Company is involved in litigation relating to claims arising in the ordinary course of business. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using available information. Views on estimated losses are developed by management in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. After taking all of the above factors into account, the Company determines whether an estimated loss from a contingency related to litigation should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. The Company further determines whether an estimated loss from a contingency related to litigation should be disclosed by assessing whether a loss is deemed probable and material. Such disclosures will include an estimate of the additional loss or range of loss or will state that such an estimate cannot be made.

Management believes that there are no claims or actions pending or threatened against the Company, the ultimate disposition of which would have a material impact on the Company s consolidated financial position, results of operations or cash flows.

7. Stockholders Equity and Stock-Based Compensation

Common Stock

The Company s amended and restated certificate of incorporation, as amended in July 2011, authorizes 350,000,000 shares of common stock with a par value of $0.0001 per share. At September 30, 2012 and December 31, 2011, there were 82,989,924 and 80,685,391 shares of common stock outstanding, respectively. Additionally, the amended certificate of incorporation authorizes the Company s board of directors, without action by stockholders, to designate and issue up to 10,000,000 shares of preferred stock in one or more series. The board of directors may also designate the rights, preferences and privileges of each series of preferred stock, any or all of which may be greater than the rights of the common stock.

Stock Compensation Plans

The Company historically maintained two stock-based compensation plans, the 2004 Stock Option Plan (the 2004 Plan) and the 2005 Stock Plan (the 2005 Plan). In May 2011, the Company adopted the 2011 Equity Incentive Plan (the 2011 Plan), which is described below.

2004 Plan

At September 30, 2012, there were 8,253,869 options outstanding under the 2004 Plan. Following the effectiveness of the Company s 2011 Plan in May 2011, no further awards will be made under the 2004 Plan, although each option previously granted under the 2004 Plan will remain outstanding subject to its terms. Any such shares of common stock that are subject to awards under the 2004 Plan which are forfeited or lapse unexercised and would otherwise have been returned to the share reserve under the 2004 Plan instead will be available for issuance under the 2011 Plan.

2005 Plan

As of September 30, 2012, there were no options outstanding under the 2005 Plan. Following the effectiveness of the Company s 2011 Plan in May 2011, no further awards will be made under the 2005 Plan.

2011 Plan

In May 2011, the Company adopted the 2011 Plan, providing for the granting of incentive stock options, as defined by the Internal Revenue Code, to employees and for the grant of non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units, performance units and performance shares to employees, directors and consultants. The 2011 Plan also provides for the automatic grant of option awards to our non-employee directors. Shares of common stock reserved for issuance under the 2011 Plan consist of 12,383,601 shares of common stock. In addition, the number of shares available for issuance under the 2011 Plan will be increased annually on the first day of the Company s fiscal year by an amount equal to the least of (a) four percent of the outstanding shares of the Company s common stock as of the last day of the Company s immediately preceding fiscal year or (b) such other amount as the Company s board of directors may determine. At September 30, 2012, there were 2,351,277 options and 710,051 restricted stock units outstanding under the 2011 Plan.