TripAdvisor, Inc.
Form 10-Q
October 23, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

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: 001-35362

TRIPADVISOR, INC.

(Exact name of registrant as specified in its charter)

Delaware	**80-0743202**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

141 Needham Street

Newton, MA 02464

(Address of principal executive office) (Zip Code)

Registrant s telephone number, including area code:

(617) 670-6300

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 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). Yes x 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	x	Accelerated filer	¨
Non-accelerated filer	¨ (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 ¨ No x

Indicates the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date:

Class	**Outstanding Shares at October 17, 2013**
Common Stock, $0.001 par value per share	129,262,489 shares
Class B common stock, $0.001 par value per share	12,799,999 shares

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For the Quarter Ended September 30, 2013

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PART 1 FINANCIAL INFORMATION

Item 1. Unaudited Consolidated Financial Statements

TRIPADVISOR, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue	$ 198,969	$ 155,835	$ 560,992	$ 429,370
Related-party revenue from Expedia	56,167	56,875	171,000	164,203
Total revenue	255,136	212,710	731,992	593,573
Costs and expenses:				
Cost of revenue (exclusive of amortization) (1)	5,207	2,876	13,135	8,536
Selling and marketing (2)	98,204	67,647	260,069	199,279
Technology and content (2)	34,398	23,535	95,116	62,950
General and administrative (2)	24,556	20,056	72,541	54,562
Depreciation	7,634	5,037	20,834	14,033
Amortization of intangible assets	1,443	1,310	4,182	4,909
Total costs and expenses	171,442	120,461	465,877	344,269
Operating income	83,694	92,249	266,115	249,304
Other income (expense):				
Interest income	475	76	1,316	260
Interest expense	(2,562)	(2,882)	(7,875)	(8,403)
Other, net	2,016	1,367	(1,595)	(2,476)
Total other expense, net	(71)	(1,439)	(8,154)	(10,619)
Income before income taxes	83,623	90,810	257,961	238,685
Provision for income taxes	(27,741)	(31,275)	(72,792)	(77,814)
Net income	55,882	59,535	185,169	160,871
Net (income) loss attributable to noncontrolling interests		(175)		(381)

Net income attributable to TripAdvisor, Inc.	$ 55,882	$ 59,360	$ 185,169	$ 160,490
Earnings Per Share attributable to TripAdvisor, Inc.:				
Basic	$ 0.39	$ 0.42	$ 1.29	$ 1.16
Diluted	$ 0.38	$ 0.41	$ 1.27	$ 1.14
Weighted Average Common Shares Outstanding:				
Basic	142,690	142,342	143,095	138,458
Diluted	145,454	143,657	145,258	140,517
(1) Excludes amortization as follows:				
Amortization of acquired technology included in amortization of intangibles	$ 245	$ 183	$ 656	$ 547
Amortization of website development costs included in depreciation	4,954	3,231	13,741	8,923
	$ 5,199	$ 3,414	$ 14,397	$ 9,470
(2) Includes stock-based compensation as follows:				
Selling and marketing	$ 2,795	$ 1,184	$ 7,354	$ 3,185
Technology and content	$ 5,479	$ 3,187	$ 15,901	$ 7,125
General and administrative	$ 3,377	$ 4,092	$ 12,215	$ 9,613

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

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TRIPADVISOR, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income	$ 55,882	$ 59,535	$ 185,169	$ 160,871
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	3,168	1,724	(393)	1,955
Available-for-sale investments:				
Change in net unrealized gain (loss)	557		(6)	
Less: reclassification adjustment for gains (losses) included in net income	(58)		(40)	
Net change (net of tax effect of $340 and ($32))	499		(46)	
Total other comprehensive income (loss), net of tax	3,667	1,724	(439)	1,955
Comprehensive income	59,549	61,259	184,730	162,826
Less: Comprehensive (income) loss attributable to noncontrolling interests		(175)		(381)
Comprehensive income attributable to TripAdvisor, Inc.	$ 59,549	$ 61,084	$ 184,730	$ 162,445

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

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TRIPADVISOR, INC.

UNAUDITED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 276,358	$ 367,515
Short-term marketable securities (note 4)	155,997	118,970
Receivable sale of marketable securities (note 4)	40,406	
Accounts receivable, net of allowance of $3,331 and $2,818 at September 30, 2013 and December 31, 2012, respectively	111,138	81,459
Receivable from Expedia, Inc., net (note 14)	33,882	23,971
Taxes receivable	10,187	24,243
Deferred income taxes, net	5,795	5,971
Prepaid expenses and other current assets	13,989	10,365
Total current assets	647,752	632,494
Long-term marketable securities (note 4)	163,525	99,248
Property and equipment, net	64,551	43,802
Deferred income taxes, net	4,218	502
Other long-term assets	16,414	13,274
Intangible assets, net (note 7)	51,007	38,190
Goodwill (note 7)	500,686	471,684
TOTAL ASSETS	$ 1,448,153	$ 1,299,194
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 11,985	$ 12,796
Deferred merchant payables (note 2)	28,596	1,303
Deferred revenue	44,087	31,563
Credit facility borrowings (note 5)	26,177	32,145
Borrowings, current (note 5)	40,000	40,000
Taxes payable	10,798	14,597
Accrued expenses and other current liabilities (note 8)	95,168	63,236
Total current liabilities	256,811	195,640
Deferred income taxes, net	10,261	11,023
Other long-term liabilities	42,275	25,563

Borrowings, net of current portion (note 5)	310,000	340,000
Total Liabilities	619,347	572,226
Commitments and Contingencies (note 9)		
Stockholders equity:		
Preferred stock $0.001 par value		
Authorized shares: 100,000,000		
Shares issued and outstanding: 0 and 0		
Common stock $0.001 par value	131	130
Authorized shares: 1,600,000,000		
Shares issued: 131,372,883 and 130,060,138		
Shares outstanding: 129,289,174 and 130,060,138		
Class B common stock $0.001 par value	13	13
Authorized shares 400,000,000		
Shares issued and outstanding: 12,799,999 and 12,799,999		
Additional paid-in capital	590,685	531,256
Retained earnings	381,607	196,438
Accumulated other comprehensive loss	(1,308)	(869)
Treasury stock Common stock, at cost, 2,083,709 and 0 shares, at September 30, 2013 and December 31, 2012 respectively	(142,322)	
Total stockholders equity	828,806	726,968
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,448,153	$ 1,299,194

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

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TRIPADVISOR, INC.

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013

(In thousands, except share data)

	Common stock Shares	Common stock Amount	Class B common stock Shares	Class B common stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock Shares	Treasury stock Amount	Total
Balance as of December 31, 2012	**130,060,138**	**$ 130**	**12,799,999**	**$ 13**	**$ 531,256**	**$ 196,438**	**$ (869)**		$	**$ 726,968**
Net income attributable to TripAdvisor, Inc.						185,169				185,169
Currency translation adjustments							(393)			(393)
Unrealized loss on marketable securities, net of tax and reclassification adjustments							(46)			(46)
Issuance of common stock related to exercise of options and vesting of RSUs	1,312,745	1			24,422					24,423
Repurchase of common stock								(2,083,709)	(142,322)	(142,322)
Tax benefits on equity awards					8,813					8,813
Minimum withholding taxes on net					(9,878)					(9,878)

share settlements of equity awards										
Stock-based compensation expense					36,072					36,072
Balance as of September 30, 2013	**131,372,883**	**$ 131**	**12,799,999**	**$ 13**	**$ 590,685**	**$ 381,607**	**$ (1,308)**	**(2,083,709)**	**$ (142,322)**	**$ 828,806**

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

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TRIPADVISOR, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine months ended September 30, 2013	2012
Operating activities:		
Net income	$ 185,169	$ 160,871
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment, including amortization of internal-use software and website development	20,834	14,033
Stock-based compensation	35,470	19,923
Amortization of intangible assets	4,182	4,909
Amortization of deferred financing costs	594	683
Amortization of discounts and premiums on marketable securities, net	3,821	
Deferred tax (benefit) expense	(452)	413
Excess tax benefits from stock-based compensation	(8,807)	(2,189)
Provision (recovery) for doubtful accounts	1,378	(1,584)
Foreign currency transaction (gains) losses, net	29	1,779
Other, net	1,600	21
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(28,625)	(32,461)
Related parties	(9,898)	(25,500)
Taxes receivable	14,056	(4,006)
Prepaid expenses and other assets	(3,222)	(1,885)
Accounts payable	(3,277)	3,641
Deferred merchant payables	12,769	(1,021)
Taxes payable	21,205	(528)
Accrued expenses and other liabilities	22,492	20,447
Deferred revenue	9,005	10,383
Net cash provided by operating activities	278,323	167,929
Investing activities:		
Acquisitions, net of cash acquired	(31,516)	
Capital expenditures, including internal-use software and website development	(39,318)	(20,587)
Purchases of marketable securities	(375,368)	
Sales of marketable securities	123,647	
Maturities of marketable securities	105,739	
Proceeds from Expedia, Inc. related to Spin-Off		7,028
Other, net	350	
Net cash used in investing activities	(216,466)	(13,559)

Financing activities:		
Repurchase of common stock	(137,565)	
Proceeds from credit facilities	8,080	12,798
Payments on credit facilities	(14,728)	(10,000)
Principal payments on long-term debt	(30,000)	(15,000)
Proceeds from exercise of stock options and warrants	21,058	226,251
Payment of minimum withholding taxes on net share settlements of equity awards	(9,878)	(3,689)
Excess tax benefits from stock-based compensation	8,807	2,189
Net cash (used) provided by financing activities	(154,226)	212,549
Effect of exchange rate changes on cash and cash equivalents	1,212	(2,079)
Net (decrease) increase in cash and cash equivalents	(91,157)	364,840
Cash and cash equivalents at beginning of year	367,515	183,532
Cash and cash equivalents at end of period	$ 276,358	$ 548,372
Supplemental disclosure of non-cash investing activities:		
Marketable securities sold during the period but settled after period end	$ 40,406	$

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

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TRIPADVISOR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND BASIS OF PRESENTATION

We refer to TripAdvisor, Inc. and our wholly-owned subsidiaries as TripAdvisor, the Company, us, we and our these notes to the unaudited consolidated financial statements.

During 2011, Expedia, Inc., or Expedia, announced its plan to separate into two independent public companies in order to better achieve certain strategic objectives of its various businesses. We refer to this transaction as the Spin-Off. On December 20, 2011, following the close of trading on the NASDAQ Global Select Market (NASDAQ), the Spin-Off was completed, and TripAdvisor began trading as an independent public company on December 21, 2011. Expedia effected the Spin-Off by means of a reclassification of its capital stock that resulted in the holders of Expedia capital stock immediately prior to the time of effectiveness of the reclassification having the right to receive a proportionate amount of TripAdvisor capital stock. In connection with the Spin-Off, Expedia contributed or transferred all of the subsidiaries and assets relating to Expedia s TripAdvisor Media Group to TripAdvisor and TripAdvisor assumed all of the liabilities relating to Expedia s TripAdvisor Media Group.

Our common stock trades on the NASDAQ under the trading symbol TRIP.

Description of Business

TripAdvisor is an online travel company, empowering users to plan and have the perfect trip. TripAdvisor s travel research platform aggregates reviews and opinions of members about destinations, accommodations (including hotels, bed and breakfasts, specialty lodging and vacation rentals), restaurants and activities throughout the world through our flagship TripAdvisor brand. TripAdvisor-branded websites include tripadvisor.com in the United States and localized versions of the website in 33 countries, including in China under the brand daodao.com. Beyond travel-related content, TripAdvisor websites also include links to the websites of our travel advertisers allowing travelers to directly book their travel arrangements. In addition to the flagship TripAdvisor brand, we manage and operate 20 other travel media brands: www.airfarewatchdog.com, www.bookingbuddy.com, www.cruisecritic.com, www.everytrail.com, www.familyvacationcritic.com, www.flipkey.com, www.gateguru.com, www.holidaylettings.co.uk, www.holidaywatchdog.com, www.independenttraveler.com, www.jetsetter.com, www.niumba.com, www.onetime.com, www.seatguru.com, www.smartertravel.com, www.tingo.com, www.travelpod.com, www.virtualtourist.com, www.whereivebeen.com, and www.kuxun.cn, connected by the common goal of providing comprehensive travel planning resources across the travel sector. We derive substantially all of our revenue from advertising, primarily through click-based advertising and display-based advertising sales. In addition, we earn revenue through a combination of subscription-based offerings from our Business Listings and Vacation Rental products, transaction revenue from selling room nights on our transactional sites, and other revenue including licensing our content to third-parties. We have one reportable segment: TripAdvisor. The segment is determined based on how our chief operating decision maker manages our business, makes operating decisions and evaluates operating performance.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by us in accordance with generally accepted accounting principles, or GAAP, for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under generally accepted accounting principles for complete periods have been condensed or omitted pursuant to such regulations. In the opinion of management, all adjustments considered necessary for a fair presentation of our financial position, results of operations and cash flows have been included. All such adjustments are of a normal recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2012 in our Annual Report on Form 10-K. The results for interim periods are not necessarily indicative of the results to be expected for the full year. The financial statements and related financial disclosures have been presented on a consolidated basis.

Consolidation

Our consolidated financial statements include the accounts of TripAdvisor, our wholly owned subsidiaries, and entities we control, or in which we have a variable interest and are the primary beneficiary of expected cash profits or losses. We record noncontrolling interest in our consolidated financial statements to recognize the minority ownership interest in our consolidated subsidiaries. Noncontrolling interest in the earnings and losses of consolidated subsidiaries represent the share of net income or loss allocated to members or partners in our consolidated entities. Significant intercompany transactions between the TripAdvisor consolidated entities and accounts have been eliminated.

Certain of our subsidiaries that operate in China have variable interests in affiliated entities in China in order to comply with Chinese laws and regulations, which restrict foreign investment in Internet content provision businesses. Although we do not own the capital stock of some of our Chinese affiliates, we consolidate their results as we are the primary beneficiary of the cash losses or profits of these variable interest affiliates and have the power to direct the activities of these affiliates. Although we currently operate at a loss in the Chinese market, our variable interest entities are not material for all periods presented.

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Accounting Estimates

We use estimates and assumptions in the preparation of our consolidated financial statements in accordance with GAAP. Our estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of our consolidated financial statements. These estimates and assumptions also affect the reported amount of net income or loss during any period. Our actual financial results could differ significantly from these estimates. The significant estimates underlying our consolidated financial statements include revenue recognition; recoverability of long-lived assets, valuation and impairment of marketable securities, intangible assets and goodwill; income taxes; useful lives of property and equipment; purchase accounting and stock-based compensation.

Reclassifications

We have reclassified certain amounts related to our prior period results to conform to our current period presentation.

Seasonality

Expenditures by travel advertisers tend to be seasonal. Traditionally, our strongest quarter has been the third quarter, which is a key travel research period, with the weakest quarter being the fourth quarter. However, adverse economic conditions or continued growth of our international operations with differing holiday peaks may influence the typical trend of our seasonality in the future.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

Deferred Merchant Payables

We receive cash from travelers at the time of booking related to our transaction-based businesses and we record these amounts, net of commissions, on our consolidated balance sheets as deferred merchant payables. We pay the hotel or vacation rental owners after the travelers use and subsequent billing from the hotel or vacation rental owners. Therefore, we receive cash from the traveler prior to paying the hotel or vacation rental owners, and this operating cycle represents a working capital source of cash to us. As long as our transaction-based businesses grow, we expect that changes in working capital related to these transactions will positively impact operating cash flows. As of September 30, 2013, our deferred merchant payables balance was $28.6 million and for the nine months ended September 30, 2013, the related transactions generated positive operating cash flow of $12.8 million. A payable balance of $14.5 million was acquired with our business acquisitions during the nine months ended September 30, 2013. For additional information on our business acquisitions refer to Note 6 *Acquisitions* below. The deferred merchant payables balance at December 31, 2012 was $1.3 million.

There have been no material changes or other additions to our significant accounting policies since December 31, 2012. For additional information about our critical accounting policies and estimates, refer to Note 2 *Significant Accounting Policies*, included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Recently Adopted Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the Financial Accounting Standards Board, or FASB, issued new accounting guidance which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. The new guidance requires that companies present, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified based on its source and is effective for public companies in interim and annual reporting periods beginning after December 15, 2012. Accordingly, we have adopted these presentation requirements during the first quarter of 2013. The adoption of this new guidance did not have a material impact on our consolidated financial statements or related disclosures.

New Accounting Pronouncements Not Yet Adopted

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the FASB issued new accounting guidance on the presentation of unrecognized tax benefits. The new guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013, with early adoption permitted. Accordingly, we plan to adopt these presentation requirements during the first quarter of 2014. The adoption of this new guidance is not expected to have a material impact on our consolidated financial statements or related disclosures.

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NOTE 3: STOCK BASED AWARDS AND OTHER EQUITY INSTRUMENTS

Stock-based compensation expense relates primarily to expense for restricted stock units (RSUs) and stock options. Our outstanding RSUs and stock options generally vest over four years.

For the three and nine months ended September 30, 2013, we recognized total stock-based compensation expense of $11.7 million and $35.5 million, respectively. The total income tax benefit related to stock-based compensation expense was $4.4 million and $13.8 million for the three and nine months ended September 30, 2013, respectively. For the three and nine months ended September 30, 2012, we recognized total stock-based compensation expense of $8.5 million and $19.9 million, respectively. The total income tax benefit related to stock-based compensation expense was $3.2 million and $7.2 million for the three and nine months ended September 30, 2012, respectively.

TripAdvisor, Inc. 2011 Stock and Annual Incentive Plan, As Amended

On December 20, 2011, our 2011 Stock and Annual Incentive Plan became effective. At our annual meeting of stockholders held on June 28, 2013 (the Annual Meeting), our stockholders approved an amendment to our 2011 Stock and Annual Incentive Plan to, among other things, increase the aggregate number of shares of common stock authorized for issuance thereunder by 15,000,000 shares. We refer to our 2011 Stock and Annual Incentive Plan, as amended by the amendment as the 2011 Incentive Plan. A summary of the material terms of the 2011 Incentive Plan can be found in Proposal 3: Approval of the 2011 Stock and Annual Incentive Plan, as amended in our Proxy Statement for the Annual Meeting. The summary of the material terms of the 2011 Incentive Plan is qualified in its entirety by the full text of the 2011 Incentive Plan previously filed.

2013 Stock Option Activity

The exercise price for all stock options granted by us to date has been equal to the market price of the underlying shares of common stock at the date of grant. In this regard, when making stock option awards, our practice is to determine the applicable grant date and to specify that the exercise price shall be the closing price of our common stock on the date of grant. Stock options granted during the first nine months of 2013 generally have a term of ten years from the date of grant and generally vest over a four-year service period.

During the nine months ended September 30, 2013, we granted 2,776,247 primarily service-based stock options under the 2011 Incentive Plan with a weighted average grant-date fair value per option of $28.11. We will amortize the fair value, net of estimated forfeitures, as stock-based compensation expense over the vesting term of generally four years on a straight-line basis, with the amount of compensation expense recognized at any date at least equaling the portion of the grant-date fair value of the award that is vested at that date. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment in the period of change which also impacts the amount of stock compensation expense to be recognized in future periods.

A summary of the status and activity for stock option awards relating to our common stock for the nine months ended September 30, 2013, is presented below:

	Options Outstanding	Weighted Average Exercise	Weighted Average Remaining	Aggregate Intrinsic Value

	(In thousands)	Price Per Share	Contractual Life (In years)	(In thousands)
Options outstanding at January 1, 2013	8,654	$ 31.41		
Granted	2,776	57.66		
Exercised (1)	1,273	23.53		$ 45,300
Cancelled	481	37.34		
Options outstanding at September 30, 2013	9,676	$ 39.69	6.1	$ 349,716
Exercisable as of September 30, 2013	3,499	$ 29.83	3.2	$ 160,963
Vested and expected to vest after September 30, 2013	8,813	$ 39.46	5.9	$ 320,645

(1) Inclusive of 168,795 options which were not converted into shares due to net share settlement in order to cover the aggregate exercise price and the minimum amount of required employee withholding taxes. Potential shares which had been convertible under stock options that were withheld under net share settlement remain in the authorized but unissued pool under the 2011 Incentive Plan and can be reissued by the Company. We began net-share settling the majority of our stock option exercises during the third quarter of 2013. Total payments for the employees tax obligations to the taxing authorities due to net share settlements are reflected as a financing activity within the consolidated statements of cash flows.

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Aggregate intrinsic value represents the difference between the closing stock price of our common stock and the exercise price of outstanding, in-the-money options. Our closing stock price as reported on NASDAQ as of September 30, 2013 was $75.84.

The estimated fair value of the options granted under the 2011 Incentive Plan was calculated using a Black-Scholes Merton option-pricing model (Black-Scholes model). The Black-Scholes model incorporates assumptions to value stock-based awards, which includes the risk-free rate of return, expected volatility, expected term and expected dividend yield.

Our risk-free interest rate is based on the rates currently available on zero-coupon U.S. Treasury issues, in effect at the time of the grant, whose remaining maturity period most closely approximates the stock option s expected term assumption. We estimated the volatility of our common stock by using an average of our historical stock price volatility and of publicly traded companies that we consider peers based on daily price observations over a period equivalent to or approximate to the expected term of the stock option grants. The decision to use a weighted average volatility factor of a peer group was based upon the relatively short period of availability of data on our common stock. We estimated our expected term using the simplified method for all stock options as we do not have sufficient historical exercise data on our common stock. Our expected dividend yield is zero, as we have not paid any dividends on our common stock to date and do not expect to pay any cash dividends for the foreseeable future.

The fair value of stock option grants under the 2011 Incentive Plan has been estimated at the date of grant using the Black Scholes model with the following weighted average assumptions for the periods presented below:

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012**	**2013**	**2012**
Risk free interest rate	1.83%	0.90%	1.40%	1.03%
Expected term (in years)	5.80	6.25	6.05	6.22
Expected volatility	49.62%	54.78%	50.81%	53.54%
Expected dividend yield	0%	0%	0%	0%

2013 RSU Activity

During the nine months ended September 30, 2013, we granted 1,083,082 primarily service-based RSUs under the 2011 Incentive Plan for which the fair value was measured based on the quoted price of our common stock at the date of grant. We will amortize the fair value, net of estimated forfeitures, as stock-based compensation expense over the vesting term of generally four years on a straight-line basis, with the amount of compensation expense recognized at any date at least equaling the portion of the grant-date fair value of the award that is vested at that date.

The following table presents a summary of RSU activity on our common stock:

	RSUs Outstanding	Weighted Average Grant-Date Fair Value Per	Aggregate Intrinsic Value

		Share	
	(In thousands)		(In thousands)
Unvested RSUs outstanding as of January 1, 2013	446	$ 26.11	
Granted	1,083	48.84	
Vested and released (1)	333	22.51	
Cancelled	76	44.81	
Unvested RSUs outstanding as of September 30, 2013	1,120	$ 47.27	$ 84,989

(1) Inclusive of 127,199 RSUs withheld to satisfy employee minimum tax withholding requirements due to net share settlement. Potential shares which had been convertible under RSUs that were withheld under net share settlement remain in the authorized but unissued pool under the 2011 Incentive Plan and can be reissued by the Company. Total payments for the employees tax obligations to the taxing authorities due to net share settlements are reflected as a financing activity within the consolidated statements of cash flows.

A summary of the unrecognized compensation expense, net of estimated forfeitures, and the weighted average period remaining at September 30, 2013 related to our non-vested stock options and RSU awards is presented below (in thousands, except year information):

	Stock Options	**RSUs**
Unrecognized compensation expense (net of forfeitures)	$ 100,509	$ 32,061
Weighted average period remaining (in years)	3.46	3.29

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All shares of common stock issued in respect of the exercise of options or other equity awards since Spin-Off have been issued from authorized, but unissued common stock.

NOTE 4: FINANCIAL INSTRUMENTS

Cash, Cash Equivalents and Marketable Securities

The following tables show our cash and available-for-sale securities amortized cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short and long-term marketable securities as of September 30, 2013 and December 31, 2012 (in thousands):

	September 30, 2013						
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents(1)	Short-Term Marketable Securities	Long-Term Marketable Securities
Cash (1)	$ 231,400	$	$	$ 231,400	$ 231,400	$	$
Level 1:							
Money market funds	44,958			44,958	44,958		
Subtotal	44,958			44,958	44,958		
Level 2:							
U.S. agency securities	38,522	13	(28)	38,507		16,026	22,481
U.S. treasury securities	15,298	1		15,299		15,299	
Certificates of deposit	19,200	22		19,222		16,221	3,001
Commercial paper	999	1		1,000		1,000	
Corporate securities	240,755	77	(339)	240,493		102,450	138,043
Municipal securities	5,001			5,001		5,001	
Subtotal	319,775	114	(367)				