

TRAVELZOO INC  
Form 10-Q  
August 11, 2008

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2008**

**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 No.: 000-50171**

**TRAVELZOO INC.**

*(Exact name of registrant as specified in its charter)*

**DELAWARE**

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

**36-4415727**

*(I.R.S. employer  
identification no.)*

**590 Madison Avenue, 37th Floor,  
New York, New York**

*(Address of principal executive offices)*

**10022**

*(Zip code)*

Registrant's telephone number, including area code: **(212) 484-4900**

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  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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

*(Do not check if a 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

The number of shares of Travelzoo common stock outstanding as of August 5, 2008 was 14,285,479 shares.

**TRAVELZOO INC.**  
**Table of Contents**

|  | <b>Page</b> |
|--|-------------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>   |             |
| <u>Item 1. Unaudited Condensed Consolidated Financial Statements</u>   |             |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007</u>                           | 3           |
| <u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2008 and 2007</u> | 4           |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007</u>           | 5           |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 6           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>             | 14          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>  | 33          |
| <u>Item 4. Controls and Procedures</u>   | 33          |
| <b><u>PART II OTHER INFORMATION</u></b>  |             |
| <u>Item 1A. Risk Factors</u>   | 33          |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>                                       | 33          |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>   | 34          |
| <u>Item 6. Exhibits</u>  | 34          |
| <u>Signature</u>   | 35          |
| <u>EXHIBIT 31.1</u>  |             |
| <u>EXHIBIT 31.2</u>  |             |
| <u>EXHIBIT 32.1</u>  |             |
| <u>EXHIBIT 32.2</u>  |             |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Unaudited Condensed Consolidated Financial Statements**

**TRAVELZOO INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(In thousands, except par value)**

|  | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|--|--------------------------|------------------------------|
| <b>ASSETS</b>  |                          |                              |
| Current assets:  |                          |                              |
| Cash and cash equivalents  | \$ 21,017                | \$ 22,641                    |
| Accounts receivable, less allowance for doubtful accounts of \$265 and \$290 as of June 30, 2008 and December 31, 2007, respectively                               | 11,566                   | 9,969                        |
| Deposits   | 202                      | 272                          |
| Prepaid expenses and other current assets  | 1,901                    | 1,982                        |
| Deferred income taxes  | 1,393                    | 1,393                        |
| Total current assets   | 36,079                   | 36,257                       |
| Deposits, less current portion   | 378                      | 349                          |
| Restricted cash  | 875                      |                              |
| Property and equipment, net  | 2,156                    | 622                          |
| Intangible assets, net   | 53                       | 58                           |
| Total assets   | \$ 39,541                | \$ 37,286                    |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                          |                              |
| Current liabilities:   |                          |                              |
| Accounts payable   | \$ 7,707                 | \$ 4,960                     |
| Accrued expenses   | 5,265                    | 4,608                        |
| Deferred revenue   | 756                      | 450                          |
| Deferred rent  | 30                       | 37                           |
| Total current liabilities  | 13,758                   | 10,055                       |
| Long-term tax liabilities  | 1,289                    | 1,256                        |
| Deferred rent, less current portion  | 795                      | 73                           |
| Commitments and contingencies  |                          |                              |
| Stockholders equity:   |                          |                              |
| Common stock, \$0.01 par value (40,000 shares authorized; 14,285 and 14,250 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively) | 143                      | 143                          |
| Additional paid-in capital   | 185                      |                              |
| Retained earnings  | 23,740                   | 25,939                       |

Edgar Filing: TRAVELZOO INC - Form 10-Q

|  |           |           |
|--|-----------|-----------|
| Accumulated other comprehensive loss       | (369)     | (180)     |
| Total stockholders' equity                 | 23,699    | 25,902    |
| Total liabilities and stockholders' equity | \$ 39,541 | \$ 37,286 |

See accompanying notes to unaudited condensed consolidated financial statements.

3

---

**Table of Contents**

**TRAVELZOO INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

**(In thousands, except per share amounts)**

|   | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|---|--------------------------------|-------------|------------------------------|-------------|
|   | <b>30,</b>                     |             | <b>30,</b>                   |             |
|   | <b>2008</b>                    | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
| Revenues                                    | \$ 21,769                      | \$ 20,115   | \$ 42,718                    | \$ 39,855   |
| Cost of revenues                            | 637                            | 225         | 1,166                        | 374         |
| Gross profit                                | 21,132                         | 19,890      | 41,552                       | 39,481      |
| Operating expenses:                         |                                |             |                              |             |
| Sales and marketing                         | 12,520                         | 10,745      | 25,914                       | 20,062      |
| General and administrative                  | 6,930                          | 3,392       | 12,676                       | 6,189       |
| Total operating expenses                    | 19,450                         | 14,137      | 38,590                       | 26,251      |
| Income from operations                      | 1,682                          | 5,753       | 2,962                        | 13,230      |
| Other income and expense:                   |                                |             |                              |             |
| Interest income                             | 77                             | 428         | 213                          | 792         |
| Gain (loss) on foreign currency             | (6)                            | 36          | 145                          | 35          |
| Income before income taxes                  | 1,753                          | 6,217       | 3,320                        | 14,057      |
| Income taxes                                | 2,946                          | 3,371       | 5,519                        | 7,148       |
| Net income (loss)                           | \$ (1,193)                     | \$ 2,846    | \$ (2,199)                   | \$ 6,909    |
| Basic net income (loss) per share           | \$ (0.08)                      | \$ 0.19     | \$ (0.15)                    | \$ 0.45     |
| Diluted net income (loss) per share         | \$ (0.08)                      | \$ 0.17     | \$ (0.15)                    | \$ 0.42     |
| Shares used in computing basic net income   |                                |             |                              |             |
| (loss) per share                            | 14,269                         | 15,250      | 14,260                       | 15,250      |
| Shares used in computing diluted net income |                                |             |                              |             |
| (loss) per share                            | 14,269                         | 16,482      | 14,260                       | 16,481      |

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**TRAVELZOO INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands)**

|  | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2008</b>                      | <b>2007</b> |
| <b>Cash flows from operating activities:</b>   |                                  |             |
| Net income (loss)  | \$ (2,199)                       | \$ 6,909    |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                  |             |
| Depreciation and amortization  | 233                              | 79          |
| Provision for losses on accounts receivable  | 66                               | (8)         |
| Tax benefit from exercise of stock options   | (110)                            |             |
| Changes in operating assets and liabilities:   |                                  |             |
| Accounts receivable  | (1,657)                          | (1,235)     |
| Deposits   | 42                               | (67)        |
| Prepaid expenses and other current assets  | 196                              | (815)       |
| Accounts payable   | 2,332                            | 3,580       |
| Accrued expenses   | 629                              | 248         |
| Deferred revenue   | 305                              | (37)        |
| Deferred rent  | 714                              | 55          |
| Income tax payable   |                                  | 3           |
| Long-term tax liabilities  | 33                               |             |
| Net cash provided by operating activities  | 584                              | 8,712       |
| <b>Cash flows from investing activities:</b>   |                                  |             |
| Purchases of property and equipment  | (1,357)                          | (246)       |
| Restricted cash  | (875)                            |             |
| Net cash used in investing activities  | (2,232)                          | (246)       |
| <b>Cash flows from financing activities:</b>   |                                  |             |
| Proceeds from exercise of stock options  | 75                               |             |
| Tax benefit from exercise of stock options   | 110                              |             |
| Net cash provided by financing activities  | 185                              |             |
| Effect of exchange rate changes on cash and cash equivalents                             | (161)                            | (5)         |
| Net increase (decrease) in cash and cash equivalents                                     | (1,624)                          | 8,461       |
| Cash and cash equivalents at beginning of period   | 22,641                           | 33,415      |
| Cash and cash equivalents at end of period   | \$ 21,017                        | \$ 41,876   |
| Supplemental disclosure of cash flow information:  |                                  |             |
| Cash paid for income taxes, net of refunds received                                      | \$ 5,018                         | \$ 7,550    |

See accompanying notes to unaudited condensed consolidated financial statements.



Table of Contents

**TRAVELZOO INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1: The Company and Basis of Presentation**

Travelzoo Inc. (the Company or Travelzoo) is a global Internet media company. Travelzoo's publications and products include the *Travelzoo* Web sites (www.travelzoo.com, cn.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, the *Newsflash* e-mail alert service, the *SuperSearch* pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list travel deals published by Travelzoo.

Travelzoo is controlled by Ralph Bartel, who held beneficially approximately 56.9% of the outstanding shares as of August 5, 2008.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company, and its results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and related notes as of and for the year ended December 31, 2007, included in the Company's Form 10-K filed with the SEC on March 17, 2008.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated into U.S. dollars at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the period.

The results of operations for the three months and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 or any other future period, and the Company makes no representations related thereto.

Certain prior period amounts have been reclassified to conform to current year presentation. Specifically, \$219,000 and \$423,000 for the three month and six month periods ending June 30, 2007, respectively, have been reclassified from cost of revenues to general and administrative expense. These amounts are primarily costs associated with salary and benefits for software developers and professional services related to software development.

The Company was formed as a result of a combination and merger of entities founded by the Company's majority stockholder, Ralph Bartel. In 1998, Mr. Bartel founded Travelzoo.com Corporation, a Bahamas corporation, which issued 5,155,874 shares via the Internet to approximately 700,000 Netsurfer stockholders for no cash consideration. In 1998, Mr. Bartel also founded Silicon Channels Corporation, a California corporation, to operate the *Travelzoo* Web site. During 2001, Travelzoo Inc. was formed as a subsidiary of Travelzoo.com Corporation, and Mr. Bartel contributed all of the outstanding shares of Silicon Channels Corporation to Travelzoo Inc. in exchange for 8,129,273 shares of Travelzoo Inc. and options to acquire an additional 2,158,349 shares at \$1.00. The merger was accounted for as a combination of entities under common control using as-if pooling-of-interests accounting. Under this method of accounting, the assets and liabilities of Silicon Channels Corporation and Travelzoo Inc. were carried forward to the combined company at their historical costs. In addition, all prior period financial statements of Travelzoo Inc. were restated to include the combined results of operations, financial position and cash flows of Silicon Channels Corporation.

During January 2001, the Board of Directors of Travelzoo.com Corporation proposed that Travelzoo.com Corporation be merged with Travelzoo Inc. whereby Travelzoo Inc. would be the surviving entity. On March 15, 2002, the stockholders of Travelzoo.com Corporation approved the merger with Travelzoo Inc. On April 25, 2002, the

certificate of merger was filed in Delaware upon which the merger became effective and Travelzoo.com Corporation ceased to exist. Each outstanding share of common stock of Travelzoo.com

**Table of Contents**

Corporation was converted into the right to receive one share of common stock of Travelzoo Inc. Under and subject to the terms of the merger agreement, stockholders were allowed a period of two years following the effective date of the merger to receive shares of Travelzoo Inc. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation, and no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect this reduction of the number of shares reported as outstanding. As of June 30, 2008, there were 14,285,479 shares of common stock outstanding.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,069,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$9,000 for these cash payments for the six months ended June 30, 2008. The liability was \$13,000 as of June 30, 2008, including \$5,000 previously accrued as of December 31, 2007. The liability is based on the actual number of valid requests received from former stockholders through June 30, 2008 which had not yet been processed for payment. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of

Travelzoo.com Corporation holding an additional approximately 4,069,000 shares had not submitted claims under the program as of June 30, 2008.

**Note 2: Revenue Recognition**

All revenue consists of advertising sales. Advertising insertions are either sold by fixed-fee arrangements or sold by variable-fee arrangements.

The Company recognizes revenues in accordance with Securities and Exchange Commission Staff Accounting Bulletin ( SAB ) No. 104, Revenue Recognition. Advertising revenues are recognized in the period in which the advertisement is displayed, provided that

**Table of Contents**

evidence of an arrangement exists, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. Where collectibility is not reasonably assured, the revenue will be recognized upon cash collection, provided that the other criteria for revenue recognition have been met. The Company recognizes revenue for fixed-fee advertising arrangements ratably over the term of the insertion order as described below, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are recognized upon delivery. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed or clicks delivered during the period.

Under these policies, no revenue is recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is deemed reasonably assured. The Company evaluates each of these criteria as follows:

*Evidence of an arrangement.* The Company considers an insertion order signed by the client or its agency to be evidence of an arrangement.

*Delivery.* Delivery is considered to occur when the advertising has been displayed and, if applicable, the click-throughs have been delivered.

*Fixed or determinable fee.* The Company considers the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

*Collection is deemed reasonably assured.* The Company conducts a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if it is expected that the client will be able to pay amounts under the arrangement as payments become due. If it is determined that collection is not reasonably assured, then revenue is deferred and recognized upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

The Company's standard payment terms are 30 days net. Insertion orders that include fixed-fee advertising are invoiced upon acceptance of the insertion order and on the first day of each month over the term of the insertion order, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are primarily invoiced upon delivery. Insertion orders that include variable-fee advertising are invoiced at the end of the month. The Company's standard terms state that in the event that Travelzoo fails to publish advertisements as specified in the insertion order, the liability of Travelzoo to the client shall be limited to, at Travelzoo's sole discretion, a pro rata refund of the advertising fee, the placement of the advertisements at a later time in a comparable position, or the extension of the term of the insertion order until the advertising is fully delivered. The Company believes that no significant obligations exist after the full delivery of advertising.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

**Note 3: Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS 157 became effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position ( FSP ) No. 157-2, which delayed the effective date of SFAS 157 one year for all non-financial assets and non-financial liabilities, except those

recognized or disclosed at fair value in the financial statements on a recurring basis. In accordance with FSP No. 157-2, the Company will measure the remaining assets and liabilities no later than the quarter ended March 31, 2009 and have not yet determined the impact of this standard on our condensed consolidated financial statements. The partial adoption of SFAS 157 for financial assets and

**Table of Contents**

liabilities did not have a material impact on our condensed consolidated financial statements in the quarter ended June 30, 2008. See Note 4 for information and related disclosures regarding the fair value of our financial assets.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. The Company adopted SFAS 159 on January 1, 2008 and did not elect to use fair value to re-measure any of its assets or liabilities.

**Note 4: Financial Instruments**

At June 30, 2008, restricted cash consisted of a certificate of deposit for \$875,000 serving as collateral for a standby letter of credit for the security deposit of our corporate headquarters. Cash equivalents consist of highly liquid investments with remaining maturities of three months or less on the date of purchase held in money market funds. The Company believes that the carrying amounts of these financial assets are a reasonable estimate of their fair value. The fair value of these certain financial assets was determined using the following inputs at June 30, 2008 (in thousands):

|                                   | Total     | Fair Value Measurements at Reporting Date Using                               |   |  |
|-----------------------------------|-----------|---|---|--|
|                                   |           | Quoted Prices<br>in<br>Active Markets<br>for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets                            |           |   |   |  |
| Money market funds <sup>(1)</sup> | \$ 14,204 | \$ 14,204   | \$  | \$   |
| Total                             | \$ 14,204 | \$ 14,204   | \$  | \$   |

<sup>(1)</sup> Included in cash and cash equivalents on our condensed consolidated balance sheet

**Note 5: Internal-Use Software and Web Site Development**

The Company includes in fixed assets the capitalized cost of internal-use software and Web site development, including software used to upgrade and enhance its Web site and processes supporting the Company's business in accordance with Statement of Position 98-1, Accounting for the Cost of Computer Software Developed or Obtained for Internal Use and Emerging Issues Task Force Issue No. 00-02, Accounting for Website Development Costs. Costs incurred in the planning stage and operating stage are expensed as incurred while costs incurred in the application development stage and infrastructure development stage are capitalized, assuming such costs are deemed to be recoverable.

During the three month and six month periods ended June 30, 2008, the Company capitalized internal-use software and Web site development costs totaling \$515,000 and \$623,000, respectively. Web site development costs relate primarily to the development of a new travel search engine. Capitalized internal-use software and Web site development costs are amortized using the straight-line method over the estimated useful life of the software or Web site.

**Note 6: Stock-Based Compensation and Stock Options**

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment ( SFAS 123R ), which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options. Stock-based compensation for awards granted prior to January 1, 2006 is based upon the grant-date fair value of such compensation as determined under the pro forma provisions of SFAS No. 123, Accounting for Stock-Based Compensation.

As described in Note 1, as part of the consideration exchanged for the outstanding shares of Silicon Channels Corporation, the Company also issued to the majority stockholder in January 2001 fully vested and exercisable options to acquire 2,158,349 shares of common stock. The options have an exercise price of \$1.00 per share, are outstanding as of June 30, 2008, and expire in January 2011.



**Table of Contents**

In October 2001, the Company granted to each director fully vested and exercisable options to purchase 30,000 shares of common stock with an exercise price of \$2.00 per share for their services as a director in 2000 and 2001. A total of 210,000 options were granted. The options expire in October 2011. 150,000 options were exercised during the year ended December 31, 2005, 17,275 options were exercised during the year ended December 31, 2006, and 30,000 options were exercised during the six months ended June 30, 2008. As of June 30, 2008, 12,725 of these options are vested and remain outstanding.

In March 2002, Travelzoo Inc. granted to each director options to purchase 5,000 shares of common stock with an exercise price of \$3.00 per share that vested in connection with their services as a director in 2002. A total of 35,000 options were granted. The options expire in March 2012. In October 2002, 1,411 options were cancelled upon the resignation of a director. 23,589 options were exercised during the year ended December 31, 2004 and 5,000 options were exercised during the six months ended June 30, 2008. As of June 30, 2008, 5,000 of these options are vested and remain outstanding.

The Company did not record any stock-based compensation in fiscal years 2006, 2007, or in the six months ended June 30, 2008. In addition, all previously issued options vested prior to January 1, 2003.

Option activity as of June 30, 2008 and changes during the six months ended June 30, 2008 were as follows:

|   | Shares    | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life | Aggregate Intrinsic Value (in thousands) |
|---|-----------|---------------------------------|---|--|
| Outstanding at December 31, 2007              | 2,211,074 | \$ 1.03                         |   |  |
| Options exercised                             | (35,000)  | \$ 2.14                         |   |  |
| Outstanding at June 30, 2008                  | 2,176,074 | \$ 1.01                         | 2.60 years                                  | \$ 16,450                                |
| Exercisable and fully vested at June 30, 2008 | 2,176,074 | \$ 1.01                         | 2.60 years                                  | \$ 16,450                                |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of fiscal 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2008. This amount changes based on the fair market value of the Company's stock. The Company's policy is to issue shares from its authorized shares to fulfill stock option exercises.

**Note 7: Net Income (Loss) Per Share**

Net income (loss) per share has been calculated in accordance with SFAS No. 128, Earnings per Share. Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding for the period. Diluted net income (loss) per share is computed by adjusting the weighted-average number of common shares outstanding for the effect of dilutive potential common shares outstanding during the period. Potential common shares included in the diluted calculation consist of incremental shares issuable upon the exercise of outstanding stock options calculated using the treasury stock method.

**Table of Contents**

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

|  | Three Months Ended |          | Six Months Ended |          |
|--|--------------------|----------|------------------|----------|
|  | June 30,           |          | June 30,         |          |
|  | 2008               | 2007     | 2008             | 2007     |
| Basic net income (loss) per share:           |                    |          |                  |          |
| Net income (loss)                            | \$ (1,193)         | \$ 2,846 | \$ (2,199)       | \$ 6,909 |
| Weighted average common shares               | 14,269             | 15,250   | 14,260           | 15,250   |
| Basic net income (loss) per share            | \$ (0.08)          | \$ 0.19  | \$ (0.15)        | \$ 0.45  |
| Diluted net income (loss) per share:         |                    |          |                  |          |
| Net income (loss)                            | \$ (1,193)         | \$ 2,846 | \$ (2,199)       | \$ 6,909 |
| Weighted average common shares               | 14,269             | 15,250   | 14,260           | 15,250   |
| Effect of dilutive securities: stock options |                    | 1,232    |                  | 1,231    |
| Diluted weighted average common shares       | 14,269             | 16,482   | 14,260           | 16,481   |
| Diluted net income (loss) per share          | \$ (0.08)          | \$ 0.17  | \$ (0.15)        | \$ 0.42  |

Options to purchase 2,176,074 shares of common stock were outstanding as of June 30, 2008 but have been excluded from the computation of diluted net loss per share for the three months and six months ended June 30, 2008 as their effect was anti-dilutive.

**Note 8: Commitments and Contingencies**

The Company leases office space in Australia, Canada, China, France, Germany, Hong Kong, Japan, Spain, Taiwan, the U.K., and the U.S. under operating leases which expire between November 30, 2008 and January 31, 2014. The future minimum lease payments under these operating leases as of June 30, 2008 total \$15,041,000. The future lease payments consist of \$2,291,000 due in 2008, \$4,202,000 due in 2009, \$2,436,000 due in 2010, \$1,994,000 due in 2011, \$2,033,000 due in 2012 and \$2,085,000 thereafter.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which

might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,069,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$9,000 for these cash payments for the six months ended June 30, 2008. The liability was \$13,000 as of June 30, 2008, including \$5,000 previously accrued as of December 31, 2007. The liability is based on the actual number of valid requests received from former stockholders through the reporting date which had not yet been processed for payment. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes

**Table of Contents**

that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding approximately 4,069,000 shares had not submitted claims under the program.

**Note 9: Income Taxes**

In determining the quarterly provisions for income taxes, the Company uses an estimated annual effective tax rate which is based on our expected annual income and statutory tax rates in the U.S. The effective tax rate does not reflect any tax benefits from the losses of our foreign operations. For the six months ended June 30, 2008, our effective tax rate was 166%.

As of June 30, 2008 and December 31, 2007, the total amount of unrecognized tax benefits was approximately \$1.1 million, which if recognized, would reduce the Company's effective tax rate in the future periods.

The Company includes interest and penalties related to unrecognized tax positions in income tax expense. As of June 30, 2008 and December 31, 2007, the Company had approximately \$144,000 and \$111,000, respectively, in accrued interest related to uncertain tax positions. The Company has not accrued any penalties related to our uncertain tax positions as we believe that it is more likely than not that there will not be any assessment of penalties.

The Company is no longer subject to U.S. federal and certain state tax examinations for years before 2004 and is no longer subject to California tax examinations for years before 2003.

**Note 10: Segment Reporting and Significant Customer Information**

The Company manages its business geographically and has three reportable operating segments: North America, Europe and Asia Pacific. North America consists of the Company's operations in Canada and the U.S. Europe consists of the Company's operations in France, Germany, Spain, and the U.K. The Company began operations in Europe in May 2005. Asia Pacific consists of the Company's operations in Australia, China, Hong Kong, Japan, and Taiwan. The Company began operations in Asia Pacific in April 2007.

Management relies on an internal management reporting process that provides revenue and segment operating income (loss) for making financial decisions and allocating resources. Management believes that segment revenues and operating income (loss) are appropriate measures of evaluating the operational performance of the Company's segments.

The following is a summary of operating results and assets (in thousands) by business segment:

|                                      | North<br>America | Europe   | Asia<br>Pacific | Elimination | Consolidated |
|--------------------------------------|------------------|----------|-----------------|-------------|--------------|
| Three months ended June 30, 2008:    |                  |          |                 |             |              |
| Revenues from unaffiliated customers | \$ 19,129        | \$ 2,550 | \$ 90           | \$          | \$ 21,769    |
| Intersegment revenues                | 39               | 19       |                 | (58)        |              |
| Total net revenues                   | 19,168           | 2,569    | 90              | (58)        | 21,769       |
| Operating income (loss)              | 6,929            | (2,013)  | (3,235)         | 1           | 1,682        |
| Three months ended June 30, 2007:    |                  |          |                 |             |              |
| Revenues from unaffiliated customers | \$ 18,619        | \$ 1,496 | \$              | \$          | \$ 20,115    |
| Intersegment revenues                | 77               | 2        |                 | (79)        |              |
| Total net revenues                   | 18,696           | 1,498    |                 | (79)        | 20,115       |
| Operating income (loss)              | 7,313            | (1,161)  | (400)           | 1           | 5,753        |
| Six months ended June 30, 2008:      |                  |          |                 |             |              |
|                                      | North<br>America | Europe   | Asia<br>Pacific | Elimination | Consolidated |

Edgar Filing: TRAVELZOO INC - Form 10-Q

|                                      |           |          |         |      |           |
|--------------------------------------|-----------|----------|---------|------|-----------|
| Revenues from unaffiliated customers | \$ 38,019 | \$ 4,589 | \$ 110  | \$   | \$ 42,718 |
| Intersegment revenues                | 64        | 30       |         | (94) |           |
| Total net revenues                   | 38,083    | 4,619    | 110     | (94) | 42,718    |
| Operating income (loss)              | 13,193    | (4,254)  | (5,979) | 2    | 2,962     |

12

**Table of Contents**

|                                      |           |          |         |             |              |
|--------------------------------------|-----------|----------|---------|-------------|--------------|
| Six months ended June 30, 2007:      | North     |          | Asia    |             |              |
| Revenues from unaffiliated customers | America   | Europe   | Pacific | Elimination | Consolidated |
| Intersegment revenues                | \$ 37,074 | \$ 2,781 | \$      | \$          | \$ 39,855    |
|                                      | 118       | 5        |         | (123)       |              |
| Total net revenues                   | 37,192    | 2,786    |         | (123)       | 39,855       |
| Operating income (loss)              | 15,473    | (1,845)  | (400)   | 2           | 13,230       |
| As of June 30, 2008                  | North     |          | Asia    |             |              |
| Property and equipment, net:         | America   | Europe   | Pacific | Elimination | Consolidated |
| Total assets                         | \$ 1,893  | \$ 82    | \$ 181  | \$          | \$ 2,156     |
|                                      | 56,661    | 4,868    | 2,858   | (24,846)    | 39,541       |
| As of December 31, 2007              | North     |          | Asia    |             |              |
| Property and equipment, net:         | America   | Europe   | Pacific | Elimination | Consolidated |
| Total assets                         | \$ 383    | \$ 70    | \$ 169  | \$          | \$ 622       |
|                                      | 45,801    | 3,525    | 2,094   | (14,134)    | 37,286       |

Revenue for each segment is recognized based on the customer location within a designated geographic region. Property and equipment are attributed to the geographic region in which the assets are located.

Significant customer information is as follows:

| Customer           | Percent of Revenues |      | Percent of Revenues |      | Percent of Accounts Receivable |          |
|--------------------|---------------------|------|---------------------|------|--------------------------------|----------|
|                    | Three Months Ended  |      | Six Months Ended    |      | June                           | December |
|                    | 2008                | 2007 | 2008                | 2007 | 30,                            | 31,      |
| Travelport Limited | 11%                 | 16%  | 11%                 | 15%  | *                              | 14%      |
| Expedia, Inc.      | *                   | 10%  | *                   | 11%  | 11%                            | 18%      |

\* Less than 10%

The agreements with these customers are in the form of multiple insertion orders from groups of entities under common control, in either the Company's standard form or in the customer's form.

**Note 11: Comprehensive Income (Loss)**

The following are components of comprehensive income (loss) (in thousands):

|  | Three Months Ended |          | Six Months Ended |          |
|--|--------------------|----------|------------------|----------|
|  | 2008               | 2007     | 2008             | 2007     |
| Net income (loss)                        | \$ (1,193)         | \$ 2,846 | \$ (2,199)       | \$ 6,909 |
| Other comprehensive income (loss):       |                    |          |                  |          |
| Foreign currency translation adjustments | (6)                | (4)      | (189)            | (15)     |
| Total comprehensive income (loss)        | \$ (1,199)         | \$ 2,842 | \$ (2,388)       | \$ 6,894 |

Accumulated other comprehensive loss, as reflected in the condensed consolidated balance sheets, consists of cumulative foreign currency translation adjustments.

**Note 12: Foreign Currency**

Realized gains and losses from foreign currency transactions are recognized as gain or loss on foreign currency. The Company does not use any derivatives for hedging or speculative purposes.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The information in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations, assumptions, estimates and projections about Travelzoo and our industry. These forward-looking statements are subject to the many risks and uncertainties that exist in our operations and business environment that may cause actual results, performance or achievements of Travelzoo to be different from those expected or anticipated in the forward-looking statements. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, anticipates, plans, expects, in expressions are intended to identify forward-looking statements. Travelzoo's actual results and the timing of certain events could differ significantly from those anticipated in such forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed elsewhere in this report in the section entitled Risk Factors and the risks discussed in our other SEC filings. The forward-looking statements included in this report reflect the beliefs of our management on the date of this report. Travelzoo undertakes no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other circumstances occur in the future.

**Overview**

Travelzoo is a global Internet media company. We publish travel offers from hundreds of travel companies. As the Internet is becoming consumers' preferred medium to search for travel offers, we provide airlines, hotels, cruise lines, vacation packagers, and other travel companies with a fast, flexible, and cost-effective way to reach millions of users. While our products provide advertising opportunities for travel companies, they also provide Internet users with a free source of information on current sales and specials from hundreds of travel companies.

Our publications and products include the *Travelzoo* Web sites (www.travelzoo.com, cn.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.tw, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service. We also operate *SuperSearch*, a pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list deals published by Travelzoo. More than 900 travel companies purchase our advertising services.

Our revenues are advertising revenues, consisting of listing fees paid primarily by travel companies to advertise their offers on the *Travelzoo* Web sites, in the *Travelzoo Top 20* e-mail newsletter, in the *Newsflash* e-mail alert service, in *SuperSearch*, and through the *Travelzoo Network*. Revenues are principally generated from the sale of advertising in the U.S. Listing fees are based on placement, number of listings, number of impressions, or number of clickthroughs. Smaller advertising agreements typically \$2,000 or less per month typically renew automatically each month if they are not terminated by the client. Larger agreements are typically related to advertising campaigns and are not automatically renewed.

We have three operating segments based on geographic regions: North America, Europe and Asia Pacific. North America consists of our operations in Canada and the U.S. Europe consists of our operations in France, Germany, Spain, and the U.K. Asia Pacific consists of our operations in Australia, China, Hong Kong, Japan, and Taiwan.

When evaluating the financial condition and operating performance of the Company, management focuses on the following financial and non-financial indicators:

Growth in the number of subscribers to the Company's newsletters and page views of the homepages of the *Travelzoo* Web sites;

Operating margin;

Growth in revenues in the absolute and relative to the growth in reach of the Company's publications; and

Revenue per employee as a measure of productivity.





## **Table of Contents**

### **Critical Accounting Policies**

We believe that there are a number of accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amounts of revenue and the more significant areas involving management's judgments and estimates. These significant accounting policies relate to revenue recognition, the allowance for doubtful accounts, and liabilities to former stockholders. These policies, and our procedures related to these policies, are described in detail below.

#### *Revenue Recognition*

We recognize revenue on arrangements in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition. We recognize advertising revenues in the period in which the advertisement is displayed, provided that evidence of an arrangement exists, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. If fixed-fee advertising is displayed over a term greater than one month, revenues are recognized ratably over the period as described below. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed or clicks delivered during the period.

Under these policies, no revenue is recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. The Company evaluates each of these criteria as follows:

*Evidence of an arrangement.* We consider an insertion order signed by the client or its agency to be evidence of an arrangement.

*Delivery.* Delivery is considered to occur when the advertising has been displayed and, if applicable, the clickthroughs have been delivered.

*Fixed or determinable fee.* We consider the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

*Collection is reasonably assured.* We conduct a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if we expect that the client will be able to pay amounts under the arrangement as payments become due. If we determine that collection is not reasonably assured, then we defer the revenue and recognize the revenue upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

#### *Allowance for Doubtful Accounts*

We record a provision for doubtful accounts based on our historical experience of write-offs and a detailed assessment of our accounts receivable and allowance for doubtful accounts. In estimating the provision for doubtful accounts, management considers the age of the accounts receivable, our historical write-offs, the creditworthiness of the client, the economic conditions of the client's industry, and general economic conditions, among other factors. Should any of these factors change, the estimates made by management will also change, which could impact the level of our future provision for doubtful accounts. Specifically, if the financial condition of our clients were to deteriorate, affecting their ability to make payments, additional provision for doubtful accounts may be required.

#### *Liability to Former Stockholders*

On October 15, 2004, we announced a program under which we would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. We account for the cost of this program as an expense

recorded in general and administrative expenses. The ultimate total

15

---

**Table of Contents**

cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. We do not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid. We believe that only a portion of such requests were valid. In order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation.

Since the total cost of the program is not reliably estimable, the amount of expense recorded in a period is equal to the number of actual claims received during the period multiplied by (i) the number of shares held by each individual former stockholder and (ii) the applicable settlement price based on the recent price of our common stock at the date the claim is received as stipulated by the program. Requests are generally paid within 30 days of receipt. Please refer to Note 8 to our unaudited condensed consolidated financial statements for further details about our liabilities to former stockholders.

**Results of Operations**

The following table sets forth, as a percentage of total revenues, the results of our operations for the periods indicated.

|                                | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                | <b>2008</b>               | <b>2007</b> | <b>2008</b>             | <b>2007</b> |
| Revenues                       | 100.0%                    | 100.0%      | 100.0%                  | 100.0%      |
| Cost of revenues               | 2.9                       | 1.1         | 2.7                     | 0.9         |
| Gross profit                   | 97.1                      | 98.9        | 97.3                    | 99.1        |
| Operating expenses:            |                           |             |                         |             |
| Sales and marketing            | 57.5                      | 53.4        | 60.7                    | 50.3        |
| General and administrative     | 31.9                      | 16.9        | 29.7                    | 15.6        |
| Total operating expenses       | 89.4                      | 70.3        | 90.4                    | 65.9        |
| Income from operations         | 7.7                       | 28.6        | 6.9                     | 33.2        |
| Other income and expenses, net | 0.3                       | 2.3         | 0.8                     | 2.1         |
| Income before income taxes     | 8.0                       | 30.9        | 7.7                     | 35.3        |
| Income taxes                   | 13.5                      | 16.8        | 12.9                    | 17.9        |
| Net income (loss)              | (5.5%)                    | 14.1%       | (5.2%)                  | 17.4%       |

For the three months ended June 30, 2008, we reported income from operations of approximately \$1.7 million. For the six months ended June 30, 2008, we reported income from operations of approximately \$3.0 million. As of June 30, 2008, we had retained earnings of approximately \$23.7 million. Our income from operations decreased to 7.7% of revenues for the three months ended June 30, 2008 from 28.6% for the same period last year. Our income from operations decreased to 6.9% of revenues for the six months ended June 30, 2008 from 33.2% for the same period last year. The decrease in our income from operations is due primarily to an increase of our sales and marketing expenses and our general and administrative expenses (see Operating Expenses below). Our sales and marketing expenses and general and administrative expenses as a percentage of revenue increased at a higher rate than the rate of the increase of our revenues.

We do not know whether our sales and marketing expenses as a percentage of revenue will continue to increase in future periods. Increased competition in our industry may require us to increase advertising for our brand and for our products. Increases in the average cost of acquiring new subscribers (see [Subscriber Acquisition](#) below) may result in an increase of sales and marketing expenses as a percentage of revenue. We may decide to accelerate our subscriber acquisition for various strategic and tactical reasons and, as a result, increase our marketing expenses. We may see a unique opportunity for a brand marketing campaign that will result in an increase of marketing expenses. Further, our strategy to replicate our business model in selected foreign markets (see [Growth Strategy](#) below) may result in a significant increase in our sales and marketing expenses and have a material adverse impact on our results of operations. We expect fluctuations of sales and marketing expenses as a percentage of revenue from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations.

**Table of Contents**

We do not know what our general and administrative expenses as a percentage of revenue will be in future periods. There may be fluctuations that have a material impact on our results of operations. We expect our headcount to continue to increase in the future. The Company's headcount is one of the main drivers of general and administrative expenses. Therefore, we expect our absolute general and administrative expenses to continue to increase. In addition, we expect our expansion into foreign markets to result in a significant additional increase in our general and administrative expenses. We expect that we will incur significant expenses in 2008 in order to allow management to report on, and our independent auditors to opine on, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002. At this time, the total cost is not reliably estimable as it will be dependent on the number of areas requiring improvement and the extent of any required remediation efforts as well as growth of our international operations. Our general and administrative expenses as a percentage of revenue may also fluctuate depending on the number of requests received related to a program under which the Company intends to make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period.

**Reach**

The following table sets forth the number of subscribers of each of our e-mail publications in North America, Europe, and Asia Pacific as of June 30, 2008 and 2007 and the total number of page views for the homepages of the *Travelzoo* Web sites in North America, Europe, and Asia Pacific for the six months ended June 30, 2008 and 2007. Management considers the page views for the *Travelzoo* homepages as indicators for the growth of Web site traffic. Management reviews these non-financial metrics with the objective of monitoring the reach of our products and evaluating whether the Company is able to convert higher reach into higher revenues.

|   | <b>2008</b>                               | <b>June 30,<br/>2007</b> | <b>Year-over-Year<br/>Growth</b>  |
|---|---|--------------------------|-----------------------------------|
| <b>Subscribers:</b>   |   |                          |                                   |
| <b>North America</b>  |   |                          |                                   |
| <i>Travelzoo Top 20</i>                                       | 10,561,000                                | 10,358,000               | 2%                                |
| <i>Newsflash</i>  | 8,564,000                                 | 8,222,000                | 4%                                |
| <b>Europe</b>   |   |                          |                                   |
| <i>Travelzoo Top 20</i>                                       | 1,852,000                                 | 919,000                  | 102%                              |
| <i>Newsflash</i>  | 1,745,000                                 | 851,000                  | 105%                              |
| <b>Asia Pacific</b>   |   |                          |                                   |
| <i>Travelzoo Top 20</i>                                       | 913,000                                   |                          |                                   |
| <i>Newsflash</i>  | 829,000                                   |                          |                                   |
|   | <b>Six Months Ended June 30,<br/>2008</b> | <b>2007</b>              | <b>Year-over-Year<br/>Growth*</b> |
| <b>Page views of homepages of <i>Travelzoo</i> Web sites:</b> |   |                          |                                   |
| North America   | 15,772,000                                | 18,229,000               | (13)%                             |
| Europe  | 3,486,000                                 | 4,565,000                | (24)%                             |
| Asia Pacific  | 5,818,000                                 |                          |                                   |

\* The comparability of year-over-year changes of page views of the homepages of *Travelzoo* Web sites may be

limited due to the design and navigation of the Web sites. Additionally, we believe that the increased use of security software has adversely affected the tracking of page views.

In North America, revenues for the six months ended June 30, 2008 increased by 2% from the same period last year. The total number of subscribers in North America to the Travelzoo Top 20 e-mail newsletter as of June 30, 2008 increased by 2% compared to June 30, 2007 and page views of the homepages of the Travelzoo Web sites in North America for the six months ended June 30, 2008 decreased by 13% from the same period last year. In North America, revenues increased at the same rate as the rate of growth in subscribers to the Travelzoo Top 20 e-mail newsletter.

In Europe, revenues for the six months ended June 30, 2008 increased by 66% from the same period last year. The total number of subscribers in Europe to the Travelzoo Top 20 e-mail newsletter as of June 30, 2008 increased by 102% compared to June 30, 2007 and page views of the homepages of the Travelzoo Web sites in Europe for the six months ended June 30, 2008 decreased by 24% from the same period last year. In Europe, revenues increased at a lower rate than the rate of growth in subscribers to the Travelzoo Top 20 e-mail

**Table of Contents**

newsletter. Management believes that the lower rate of growth in revenues was due to start up of operations in Germany, France, and Spain. In Germany, France, and Spain, we focused on rapidly building a significant subscriber base.

In the Asia Pacific, we generated \$110,000 in revenue for the six months ended June 30, 2008. We did not generate any revenues in the Asia Pacific in the six months ended June 30, 2007. We began operations in Australia, China, Hong Kong, Japan, and Taiwan during 2007 and have focused on rapidly building a significant subscriber base in the countries in which we operate.

**Revenues**

Our total revenues increased to \$21.8 million for the three months ended June 30, 2008 from \$20.1 million for the three months ended June 30, 2007. This represents an increase of 8%. Our total revenues increased to \$42.7 million for the six months ended June 30, 2008 from \$39.9 million for the six months ended June 30, 2007. This represents an increase of 7%.

64% of our revenue growth in the three months ended June 30, 2008 compared to the three months ended June 30, 2007 came from increased revenues from our operations in Europe. 31% of our revenue growth came from our operations in North America (i.e. *Travelzoo* Web sites, *Travelzoo Top 20* newsletter, *Newsflash*, *SuperSearch* and *Travelzoo Network*) and is attributed to an increase in the number of clients in North America, an increase in the volume of advertising sold to existing clients in North America, and from new product offerings in North America. The remaining 5% of our revenue growth came from our operations in Asia Pacific which did not generate any revenues in the three months ended June 30, 2007.

63% of our revenue growth in the six months ended June 30, 2008 compared to the six months ended June 30, 2007 came from increased revenues from our operations in Europe. 33% of our revenue growth came from our operations in North America (i.e. *Travelzoo* Web sites, *Travelzoo Top 20* newsletter, *Newsflash*, *SuperSearch* and *Travelzoo Network*) and is attributed to an increase in the number of clients in North America, an increase in the volume of advertising sold to existing clients in North America, and from new product offerings in North America. The remaining 4% of our revenue growth came from our operations in Asia Pacific which did not generate any revenues in the six months ended June 30, 2007.

As discussed in Note 10 in the notes to the condensed consolidated financial statements, one client accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2008. Two clients each accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2007. No other clients accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2008 and 2007. The agreements with these clients are in the form of multiple insertion orders from groups of entities under common control. Management expects revenue concentration to remain at the current level in the foreseeable future because there is a high concentration in the online travel agency industry.

Management believes that our ability to increase revenues in the future depends mainly on the following factors:

Our ability to increase our advertising rates;

Our ability to sell more advertising to existing clients;

Our ability to increase the number of clients;

Our ability to develop new revenue streams; and

Our ability to launch new products.

We believe that we can increase our advertising rates if the reach of our publications increases. We do not know if we will be able to increase the reach of our publications. We believe that we can sell more advertising if the market for online advertising continues to grow and if we can maintain or increase our market share. We believe that the market for online advertising continues to grow. We do not know if we will be able to maintain or increase our market share. We historically have increased the number of clients in every year since inception. We do not know if we will be able to increase the number of clients in the future. We do not know if we will have market acceptance of our new



products.

**Table of Contents**

Historically, we have increased advertising rates as of January 1 of each year. However, we did not increase our advertising rates in the U.S. on January 1, 2008 due to intense price competition in our industry. We intend to review advertising rates and consider increases once a year as of January 1. However, there is no assurance that there will be increases of advertising rates. Depending on the level of competition in the industry and the condition of the online advertising market, we may decide not to increase our advertising rates.

Average annualized revenue per employee decreased to \$456,000 for the three months ended June 30, 2008 from \$712,000 for the three months ended June 30, 2007. The decrease in average revenue per employee for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to an increase in headcount related to the start-up of our business in Europe and Asia Pacific.

***Cost of Revenues***

Cost of revenues consists of network expenses, including fees we pay for co-location services, depreciation of network equipment, payments made to affiliate partners of the *Travelzoo Network*, and salary expenses associated with network operations staff. Our cost of revenues increased to \$637,000 for the three months ended June 30, 2008 from \$225,000 for the three months ended June 30, 2007. Our cost of revenues increased to \$1.2 million for the six months ended June 30, 2008 from \$374,000 for the six months ended June 30, 2007. As a percentage of revenue, cost of revenues increased to 3% for the three months and six months ended June 30, 2008 from 1% for the three months and six months ended June 30, 2007. The \$412,000 increase in cost of revenues for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a \$272,000 increase in payments made to affiliate partners of the *Travelzoo Network*. The \$792,000 increase in cost of revenues for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to a \$509,000 increase in payments made to affiliate partners of the *Travelzoo Network*.

***Operating Expenses******Sales and Marketing***

Sales and marketing expenses consist primarily of advertising and promotional expenses, salary expenses associated with sales and marketing staff, expenses related to our participation in industry conferences, and public relations expenses. Sales and marketing expenses increased to \$12.5 million for the three months ended June 30, 2008 from \$10.7 million for the three months ended June 30, 2007. Sales and marketing expenses increased to \$25.9 million for the six months ended June 30, 2008 from \$20.1 million for the six months ended June 30, 2007. The goal of our advertising was to acquire new subscribers for our e-mail products, increase the traffic to our Web sites, and increase brand awareness for *Travelzoo*. The \$1.8 million increase in sales and marketing expenses for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a \$945,000 increase in advertising to acquire new subscribers for our e-mail products and a \$1.4 million increase in salary and employee related expenses due primarily to an increase in the headcount of our sales and marketing staff offset by a \$354,000 decrease in advertising to acquire traffic to our Web site. For the three months ended June 30, 2008 and 2007, advertising expenses accounted for 59% and 68%, respectively, of total sales and marketing expenses. The \$5.9 million increase in sales and marketing expenses for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to a \$2.6 million increase in salary and employee related expenses due primarily to an increase in the headcount of our sales and marketing staff, a \$2.5 million increase in advertising to acquire new subscribers for our e-mail products, and a \$463,000 increase in advertising to acquire traffic to our Web sites. For the six months ended June 30, 2008 and 2007, advertising expenses accounted for 63% and 68% of total sales and marketing expenses, respectively.

Our goal is to increase our revenues from advertising sales. One important factor that drives our revenues is our advertising rates. We believe that we can increase our advertising rates if the reach of our publications increases. In order to increase the reach of our publications, we have to acquire a significant number of new subscribers in every quarter and continue to promote our brand. One significant factor that impacts our advertising expenses is the average cost per acquisition of a new subscriber. We believe that the average cost per acquisition depends mainly on the advertising rates which we pay for media buys, our ability to manage our subscriber acquisition efforts successfully, and the degree of competition in our industry.

In May 2005, we began operations in the U.K. In 2006, we began operations in Canada, Germany, and Spain. In 2007, we began operations in Australia, China, France, Hong Kong, Japan, and Taiwan. The start-up of our business in Europe and Asia Pacific and our plan to expand into other countries in the future is expected to result in a significant increase in our sales and marketing expenses in the foreseeable future.

**Table of Contents***General and Administrative*

General and administrative expenses consist primarily of compensation for administrative, executive, and software development staff, fees for professional services, rent, bad debt expense, amortization of intangible assets, and general office expense. General and administrative expenses increased to \$6.9 million for the three months ended June 30, 2008 from \$3.4 million for the three months ended June 30, 2007. General and administrative expenses increased to \$12.7 million for the six months ended June 30, 2008 from \$6.2 million for the six months ended June 30, 2007. The \$3.5 million increase in general and administrative expenses for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a \$2.0 million increase in salary and employee related expenses due primarily to an increase in headcount, a \$762,000 increase in rent and office expense, and a \$683,000 increase in professional services expenses. The \$6.5 million increase in general and administrative expenses for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to an \$3.6 million increase in salary and employee related expenses due primarily to an increase in headcount, a \$1.5 million increase in rent and office expense, and a \$960,000 increase in professional services expenses.

In the six months ended June 30, 2008 and 2007, the Company recorded expenses of \$9,000 and \$72,000, respectively, related to a program under which the Company makes cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. The expenses are based on the number of actual valid claims received and the Company's stock price. The Company cannot reliably estimate future expenses incurred under this program because it is based on the number of valid requests received and future levels of the Company's common stock price.

We expect our headcount to increase in the future. The Company's headcount is one of the main drivers of general and administrative expenses. Therefore, we expect our general and administrative expenses to continue to increase.

Our strategy to replicate our business model in foreign markets is expected to result in a significant additional increase in our general and administrative expenses in the foreseeable future.

**Subscriber Acquisition**

The table set forth below provides for each quarter in 2005, 2006, 2007 and the first six months of 2008, an analysis of our average cost for acquisition of new subscribers for our *Travelzoo Top 20* newsletter and our *Newsflash* e-mail alert service for our North America, Europe and Asia Pacific operating segments.

The table includes the following data:

**Average Cost per Acquisition of a New Subscriber:** This is the quarterly cost of consumer marketing programs whose purpose was primarily to acquire new subscribers, divided by total new subscribers added during the quarter.

**New Subscribers:** Total new subscribers who signed up for at least one of our e-mail publications throughout the quarter. This is an unduplicated subscriber number, meaning a subscriber who signed up for two or more of our publications is only counted once.

**Subscribers Removed From List:** Subscribers who were removed from our lists throughout the quarter either as a result of their requesting removal, or based on periodic list maintenance after we determined that the e-mail address was likely no longer valid.

**Balance:** This is the number of subscribers at the end of the quarter, computed by taking the previous quarter's subscriber balance, adding new subscribers during the current quarter, and subtracting unsubscribes during the current quarter.

**Table of Contents**

North America:

| Period  | Average Cost<br>per<br>Acquisition of<br>a<br>New |                    | Subscribers<br>Removed |            |
|---------|---|--------------------|------------------------|------------|
|         | Subscriber  | New<br>Subscribers | From List              | Balance    |
| Q1 2005 | \$ 2.59   | 659,459            | (475,938)              | 8,329,258  |
| Q2 2005 | \$ 2.62   | 806,734            | (533,109)              | 8,602,883  |
| Q3 2005 | \$ 3.19   | 740,768            | (422,868)              | 8,920,783  |
| Q4 2005 | \$ 2.41   | 729,460            | (273,389)              | 9,376,854  |
| Q1 2006 | \$ 2.54   | 714,643            | (317,947)              | 9,773,550  |
| Q2 2006 | \$ 2.11   | 737,735            | (532,676)              | 9,978,609  |
| Q3 2006 | \$ 1.86   | 491,524            | (327,471)              | 10,142,662 |
| Q4 2006 | \$ 1.56   | 373,559            | (288,883)              | 10,227,338 |
| Q1 2007 | \$ 2.61   | 730,063            | (345,896)              | 10,611,505 |
| Q2 2007 | \$ 3.03   | 552,488            | (335,304)              | 10,828,689 |
| Q3 2007 | \$ 3.92   | 385,408            | (255,008)              | 10,959,089 |
| Q4 2007 | \$ 3.78   | 279,967            | (242,822)              | 10,996,234 |
| Q1 2008 | \$ 4.97   | 296,565            | (270,427)              | 11,022,372 |
| Q2 2008 | \$ 3.39   | 348,506            | (303,623)              | 11,067,255 |

Europe:

| Period  | Average Cost<br>per<br>Acquisition of<br>a<br>New |                    | Subscribers<br>Removed |           |
|---------|---|--------------------|------------------------|-----------|
|         | Subscriber  | New<br>Subscribers | From List              | Balance   |
| Q3 2005 | \$ 1.65   | 127,857            | (5,577)                | 140,153   |
| Q4 2005 | \$ 2.02   | 174,514            | (16,898)               | 297,769   |
| Q1 2006 | \$ 2.15   | 143,666            | (16,831)               | 424,604   |
| Q2 2006 | \$ 2.69   | 129,438            | (34,070)               | 519,972   |
| Q3 2006 | \$ 1.23   | 126,566            | (29,794)               | 616,744   |
| Q4 2006 | \$ 2.94   | 69,489             | (30,943)               | 655,290   |
| Q1 2007 | \$ 3.89   | 159,439            | (31,350)               | 783,379   |
| Q2 2007 | \$ 4.43   | 206,003            | (39,690)               | 949,692   |
| Q3 2007 | \$ 2.96   | 331,903            | (32,689)               | 1,248,906 |
| Q4 2007 | \$ 5.85   | 165,781            | (33,357)               | 1,381,330 |
| Q1 2008 | \$ 3.90   | 362,417            | (45,152)               | 1,698,595 |
| Q2 2008 | \$ 4.89   | 226,156            | (31,055)               | 1,893,696 |

Asia Pacific:

| Period | Average Cost<br>per<br>Acquisition of<br>a |                    | Subscribers<br>Removed |         |
|--------|--|--------------------|------------------------|---------|
|        | Subscriber                                 | New<br>Subscribers | From List              | Balance |

| <b>Period</b> | <b>New<br/>Subscriber</b> | <b>New<br/>Subscribers</b> | <b>From List</b> | <b>Balance</b> |
|---------------|---------------------------|----------------------------|------------------|----------------|
| Q2 2007       | \$ 2.46                   | 1,068                      | (4)              | 1,064          |
| Q3 2007       | \$ 2.23                   | 42,106                     | (138)            | 43,032         |
| Q4 2007       | \$ 2.90                   | 180,446                    | (9,013)          | 214,465        |
| Q1 2008       | \$ 3.12                   | 393,311                    | (26,199)         | 581,577        |
| Q2 2008       | \$ 3.37                   | 369,491                    | (38,048)         | 913,020        |

In North America, we have noted a trend of increasing average cost per new subscriber over the last few years, driven by a gradual increase in online advertising rates by our media suppliers as well as increased activity from competitors using similar forms of online advertising for their own marketing efforts. The decline in new subscriber acquisition costs in North America in Q3 2006 was impacted by a credit received from a vendor in the amount of \$170,000.

In Europe, we see a large fluctuation in the average cost per new subscriber. The average cost fluctuates from quarter to quarter and from country to country.

We began operations in Asia Pacific in April 2007 and started acquiring new subscribers in Australia, China, Hong Kong, Japan, and Taiwan.

**Table of Contents**

Increasing average cost per subscriber is likely to result in higher absolute marketing expenses and potentially higher relative marketing expenses as a percentage of revenue. Going forward we expect continued upward pressure on online advertising rates and continued activity from competitors, which will likely increase our cost per new subscriber over the long term. The effect on operations may be that greater absolute and relative marketing expenditure is necessary to continue to grow the reach of our publications. However, it is possible that the factors driving subscriber acquisition cost increases can be partially or completely offset by new or improved methods of subscriber acquisition using techniques which are under evaluation.

**Segment Information**

We have presented the business segments in this report based on our organizational structure as of June 30, 2008.

**North America**

|   | Three Months Ended June<br>30, |           | Six Months Ended June<br>30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2008                           | 2007      | 2008                         | 2007      |
|   | (In thousands)                 |           | (In thousands)               |           |
| Net revenues                              | \$ 19,168                      | \$ 18,696 | 38,083                       | \$ 37,192 |
| Income from operations                    | 6,929                          | 7,313     | 13,193                       | 15,473    |
| Income from operations as a % of revenues | 36.1%                          | 39.1%     | 34.6%                        | 41.6%     |

In North America, revenues increased 3% in the three months ended June 30, 2008 compared to the same period in 2007. Revenues increased 2% in the six months ended June 30, 2008 compared to the same period in 2007. The revenue growth in North America was driven by the addition of new clients, increased spending from existing clients, and new product offerings and revenue streams.

Income from operations for North America as a percentage of revenue in the three months ended June 30, 2008 compared to the three months ended June 30, 2007 decreased to 36.1% from 39.1%. Sales and marketing expenses as a percentage of revenue decreased to 40% or \$7.6 million for the three months ended June 30, 2008 from 47% or \$8.7 million for the three months ended June 30, 2007. The \$1.1 million decrease in sales and marketing expense was primarily due to a \$613,000 decrease in advertising to acquire traffic to our Web site, a \$536,000 decrease in expenses for brand marketing campaigns, and a \$492,000 decrease in advertising to acquire new subscribers for our e-mail products offset by a \$357,000 increase in salary expense. General and administrative expenses as a percentage of revenue increased to 21% or \$4.0 million for the three months ended June 30, 2008 from 13% or \$2.4 million for the three months ended June 30, 2007. The \$1.6 million increase in general and administrative expense was primarily due to a \$1.2 million increase in salary and employee related expenses and a \$328,000 increase in rent and office expense.

Income from operations for North America as a percentage of revenue in the six months ended June 30, 2008 compared to the six months ended June 30, 2007 decreased to 34.6% from 41.6%. Sales and marketing expenses as a percentage of revenue decreased to 43% or \$16.3 million for the six months ended June 30, 2008 from 45% or \$16.6 million for the six months ended June 30, 2007. The \$317,000 decrease in sales and marketing expense was primarily due to a \$924,000 decrease in advertising to acquire new subscribers for our e-mail products offset by a \$622,000 increase in salary expense. General and administrative expenses as a percentage of revenue increased to 20% or \$7.6 million for the six months ended June 30, 2008 from 13% or \$4.7 million for the six months ended June 30, 2007. The \$2.9 million increase in general and administrative expense was primarily due to a \$1.9 million increase in salary and employee related expenses and a \$637,000 increase in rent and office expense.

**Europe**

|                      | Three Months Ended June<br>30, |          | Six Months Ended June<br>30, |          |
|----------------------|--------------------------------|----------|------------------------------|----------|
|                      | 2008                           | 2007     | 2008                         | 2007     |
|                      | (In thousands)                 |          | (In thousands)               |          |
| Net revenues         | \$ 2,569                       | \$ 1,498 | \$ 4,619                     | \$ 2,786 |
| Loss from operations | (2,013)                        | (1,161)  | (4,254)                      | (1,845)  |

Edgar Filing: TRAVELZOO INC - Form 10-Q

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| Loss from operations as a % of revenues | 78.4% | 77.5% | 92.1% | 66.2% |
|   | 22    |       |       |       |

---



**Table of Contents**

In Europe, revenues increased 71% in the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Revenues increased 66% in the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The revenue growth in Europe was driven by the addition of new clients, increases in our advertising rates, increased spending from existing clients, and new product offerings and revenue streams.

Our loss from operations in Europe was \$2.0 million for the three months ended June 30, 2008 compared to a loss of \$1.2 million for the three months ended June 30, 2007. Sales and marketing expenses increased to \$3.0 million for the three months ended June 30, 2008 from \$2.0 million for the three months ended June 30, 2007. The \$1.0 million increase in sales and marketing expense was due primarily to a \$496,000 increase in salary expense, a \$259,000 increase in advertising to acquire traffic to our Web sites, and a \$193,000 increase in advertising to acquire new subscribers for our e-mail products. General and administrative expenses increased by \$896,000 to \$1.6 million for the three months ended June 30, 2008 compared to the prior year period due primarily to a \$324,000 increase in salary and employee related expenses, a \$192,000 increase in professional services expense, and a \$139,000 increase in rent and office expense.

Our loss from operations in Europe was \$4.3 million for the six months ended June 30, 2008 compared to a loss of \$1.8 million for the six months ended June 30, 2007. Sales and marketing expenses increased to \$6.1 million for the six months ended June 30, 2008 from \$3.4 million for the six months ended June 30, 2007. This \$2.7 million increase was due primarily to a \$987,000 increase in advertising to acquire new subscribers for our e-mail products, an \$894,000 increase in salary expense, and a \$597,000 increase in advertising to acquire traffic to our Web sites. General and administrative expenses increased by \$1.5 million to \$2.7 million for the six months ended June 30, 2008 compared to the prior year period due primarily to a \$657,000 increase in salary and employee related expenses, a \$318,000 increase in professional services expense, and a \$266,000 increase in rent and office expense.

**Asia Pacific**

|                      | Three Months Ended June |       | Six Months Ended June |       |
|----------------------|-------------------------|-------|-----------------------|-------|
|                      | 2008                    | 2007  | 2008                  | 2007  |
|                      | 30,                     |       | 30,                   |       |
|                      | (In thousands)          |       | (In thousands)        |       |
| Net revenues         | \$ 90                   | \$    | \$ 110                | \$    |
| Loss from operations | (3,235)                 | (400) | (5,979)               | (400) |

We began operations in Asia Pacific in the second quarter of 2007 and we did not generate any revenues in the three months and six months ended June 30, 2007. Revenues in the three months and six months ended June 30, 2008 were \$90,000 and \$110,000, respectively.

Our loss from operations in Asia Pacific was \$3.2 million for the three months ended June 30, 2008 compared to a loss of \$400,000 for the three months ended June 30, 2007. Sales and marketing expense increased to \$1.9 million for the three months ended June 30, 2008 from \$32,000 for the three months ended June 30, 2007. The increase was primarily due to a \$1.2 million increase in advertising to acquire new subscribers for our e-mail products and a \$410,000 increase in salary expense. General and administrative expenses increased to \$1.4 million for the three months ended June 30, 2008 from \$368,000 for the three months ended June 30, 2007. The increase was primarily due to a \$441,000 increase in salary and employee related expenses, a \$299,000 increase in rent and office expense, and a \$221,000 increase in professional services expense.

Our loss from operations in Asia Pacific was \$6.0 million for the six months ended June 30, 2008 compared to a loss of \$400,000 for the six months ended June 30, 2007. Sales and marketing expense increased to \$3.5 million for the three months ended June 30, 2008 from \$32,000 for the three months ended June 30, 2007. The increase was primarily due to a \$2.5 million increase in advertising to acquire new subscribers for our e-mail products and a \$746,000 increase in salary expense. General and administrative expenses increased to \$2.5 million for the three months ended June 30, 2008 from \$368,000 for the three months ended June 30, 2007. The increase was primarily due to a \$1.1 million increase in salary and employee related expenses, a \$617,000 increase in rent and office expense, and a \$333,000 increase in professional services expense.



**Table of Contents****Income Taxes**

We recorded income tax provisions of \$2.9 million and \$3.4 million for the three months ended June 30, 2008 and June 30, 2007, respectively. We recorded income tax provisions of \$5.5 million and \$7.1 million for the six months ended June 30, 2008 and June 30, 2007, respectively. Our income is generally taxed in the U.S. and our income tax provisions reflect federal and state statutory rates applicable to our levels of income and expenses, adjusted to take into account expenses that are treated as having no recognizable tax benefit. For the three months ended June 30, 2008, our effective tax rate was 168%. For the six months ended June 30, 2008, our effective tax rate was 166%. Losses of approximately \$5.2 million and \$10.0 million for the three months and six months ended June 30, 2008, respectively, from our Europe and Asia Pacific business segments were treated as having no recognizable tax benefit.

We expect that our effective tax rate in future periods may fluctuate depending on the total amount of expenses related to payments to former stockholders, from losses or gains incurred by our operations in Canada, Europe and Asia Pacific, and corresponding U.S. tax credits, if any.

**Liquidity and Capital Resources**

As of June 30, 2008, we had \$21.0 million in cash and cash equivalents. Cash and cash equivalents decreased from \$22.6 million as of December 31, 2007 primarily as a result of cash provided by operating activities offset by cash used in investing activities as explained below. We expect that cash on hand and cash flows generated from operations will be sufficient to provide for working capital needs for at least the next 12 months.

Net cash provided by operating activities in the six months ended June 30, 2008 was \$584,000. Net cash provided by operating activities in the six months ended June 30, 2007 was \$8.7 million. In the six months ended June 30, 2008, net cash provided by operating activities resulted primarily from increases in accounts payable, deferred rent, and accrued expenses offset by a net loss and an increase in accounts receivable. In the six months ended June 30, 2007, net cash provided by operating activities resulted primarily from net income and an increase in accounts payable offset by increases in accounts receivable and prepaid expenses.

Net cash used in investing activities was \$2.2 million in the six months ended June 30, 2008. Net cash used in investing activities was \$246,000 during the six months ended June 30, 2007. In the six months ended June 30, 2008 net cash used in investing activities resulted from purchases of restricted cash and property and equipment. For the six months ended June 30, 2007, net cash used in investing activities was for the purchase of property and equipment.

Net cash provided by financing activities was \$185,000 for the six months ended June 30, 2008. There were no financing activities during the six months ended June 30, 2007. For the six months ended June 30, 2008, net cash provided by financing activities was due to the exercise of stock options.

Our capital requirements depend on a number of factors, including market acceptance of our products and services, the amount of our resources we devote to development and launch of new products, expansion of our operations, including subscriber marketing, in North America, Europe, and Asia Pacific, the amount of resources we devote to promoting awareness of the *Travelzoo* brand, and cash payments to former stockholders of Travelzoo.com Corporation. Since the inception of the program under which we would make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for our shares within the required time period, we have incurred expenses of \$2.7 million. While future payments for this program are expected to decrease, the total cost of this program is still undeterminable because it is dependent on our stock price and on the number of claims ultimately received. Consistent with our growth, we have experienced substantial increases in our sales and marketing expenses and our general and administrative expenses since inception, and we anticipate that these increases will continue for the foreseeable future. We believe cash on hand and cash generated during those periods will be sufficient to pay such costs. In addition, we will continue to evaluate possible investments in businesses, products and technologies, the consummation of any of which would increase our capital requirements.

Although we currently believe that we have sufficient capital resources to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months, unanticipated events and opportunities may require us to sell additional equity or debt securities or establish new credit facilities to raise capital in order to meet our capital requirements. If we sell additional equity or convertible debt securities, the sale could dilute the ownership of our existing stockholders. If we issue debt securities or establish a new credit facility, our fixed obligations could increase, and we may be required to agree to operating covenants that would restrict our operations. We cannot be

sure that any such financing will be available in amounts or on terms acceptable to us.

**Table of Contents**

We expect that cash on hand will be sufficient to finance the expansion of our operations in Europe and Asia Pacific for at least the next 12 months.

The following summarizes our principal contractual commitments as of June 30, 2008 (in thousands):

|                      | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>Thereafter</b> | <b>Total</b> |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| Operating leases     | \$ 2,291    | \$ 4,202    | \$ 2,436    | \$ 1,994    | \$ 2,033    | \$ 2,085          | \$ 15,041    |
| Purchase obligations | 826         |             |             |             |             |                   | 826          |
| Total commitments    | \$ 3,117    | \$ 4,202    | \$ 2,436    | \$ 1,994    | \$ 2,033    | \$ 2,085          | \$ 15,867    |

The table above excludes net unrecognized tax benefits of approximately \$1.1 million as of June 30, 2008, because the Company is unable to make reasonably reliable estimates on the timing of the cash settlements with the respective taxing authorities.

**Growth Strategy**

Our growth strategy has two main elements:

Replicate our business model in selected foreign markets in Asia Pacific and in Europe; and

Expand the scope of our business model.

In 2007, we started up operations in Australia, China, France, Hong Kong, Japan, and Taiwan. We plan to start up operations in South Korea in 2009.

In 2007, we began to allocate significant resources to the development of the *Travelzoo Network*, a network of third-party Web sites that list travel deals published by Travelzoo.

In 2008, we are continuing to develop shows and events listings.

In 2008, we plan to launch a new travel search engine.

**Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS 157 became effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position ( FSP ) No. 157-2, which delayed the effective date of SFAS 157 one year for all non-financial assets and non-financial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. In accordance with FSP No. 157-2, we will measure the remaining assets and liabilities no later than the quarter ended March 31, 2009 and have not yet determined the impact of this standard on our condensed consolidated financial statements. The partial adoption of SFAS 157 for financial assets and liabilities did not have a material impact on our condensed consolidated financial statements in the six months ended June 30, 2008. See Note 4 for information and related disclosures regarding the fair value of our financial assets.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. The Company adopted SFAS 159 on January 1, 2008 and did not elect to use fair value to re-measure any of its assets or liabilities.

**Table of Contents**

**RISK FACTORS**

*Investing in our common stock involves a high degree of risk. Any or all of the risks listed below as well as other variables affecting our operating results could have a material adverse effect on our business, our quarterly and annual operating results or financial condition, which could cause the market price of our stock to decline or cause substantial volatility in our stock price, in which event the value of your common stock could decline. You should also keep these risk factors in mind when you read forward-looking statements.*

**Risks Related to Our Financial Condition and Business Model**

***We cannot assure you that we will be profitable.***

In the six months ended June 30, 2008, we generated a net loss. Although we generated net income in 2007, there is no assurance that we will be profitable in the future. It is likely that we will not sustain profitability in 2008. We expect our operations in Asia Pacific and Europe to incur significant losses in the foreseeable future and we expect that this will have a material negative impact on our operating margins and net income. Furthermore, we forecast our future expense levels based on our operating plans and our estimates of future revenues. We may find it necessary to significantly accelerate expenditures relating to our sales and marketing efforts or otherwise increase our financial commitment to creating and maintaining brand awareness among Internet users and travel companies. If our revenues grow at a slower rate than we anticipate, or if our spending levels exceed our expectations or cannot be adjusted to reflect slower revenue growth, we may not generate sufficient revenues to sustain profitability. Any of these developments could result in a significant decrease in the trading price of our common stock.

***Fluctuations in our operating results may negatively impact our stock price.***

Our quarterly operating results may fluctuate significantly in the future due to a variety of factors that could affect our revenues or our expenses in any particular quarter. You should not rely on quarter-to-quarter comparisons of our results of operations as an indication of future performance. Factors that may affect our quarterly results include:

mismatches between resource allocation and client demand due to difficulties in predicting client demand in a new market;

changes in general economic conditions that could affect marketing efforts generally and online marketing efforts in particular;

the magnitude and timing of marketing initiatives, including our acquisition of new subscribers and our expansion efforts in other regions;

the introduction, development, timing, competitive pricing and market acceptance of our products and services and those of our competitors;

our ability to attract and retain key personnel;

our ability to manage our anticipated growth and expansion;

our ability to attract traffic to our Web sites;

technical difficulties or system downtime affecting the Internet generally or the operation of our products and services specifically;

payments which we may make to previous stockholders of Travelzoo.com Corporation who failed to submit requests for shares in Travelzoo Inc. within the required time period; and

volatility of our operating results in new markets.

We may significantly increase our operating expenses related to advertising campaigns for *Travelzoo* for a certain period if we see a unique opportunity for a brand marketing campaign, if we find it necessary to respond to increased

brand marketing by a competitor, or if we decide to accelerate our acquisition of new subscribers.

**Table of Contents**

If revenues fall below our expectations in any quarter and we are unable to quickly reduce our operating expenses in response, our operating results would be lower than expected and our stock price may fall.

***We depend on one client for a substantial part of our revenues.***

In the six months ended June 30, 2008, one client accounted for 11% of our revenues. The agreements with this client are in the form of multiple insertion orders from entities under the common control of this client, in either the Company's standard form or in the client's form. The loss of this client may result in a significant decrease in our revenues, which could have a material adverse effect on our business.

***Our business model may not be adaptable to a changing market.***

Our current revenue model depends on advertising fees paid primarily by travel companies. If current clients decide not to continue advertising their offers with us and we are unable to replace them with new clients, our business may be adversely affected. To be successful, we must provide online marketing solutions that achieve broad market acceptance by travel companies. In addition, we must attract sufficient Internet users with attractive demographic characteristics to our products. It is possible that we will be required to further adapt our business model in response to changes in the online advertising market or if our current business model is not successful. If we are not able to anticipate changes in the online advertising market or if our business model is not successful, our business could be materially adversely affected.

***We may not be able to obtain sufficient funds to grow our business and any additional financing may be on terms adverse to your interests.***

We intend to continue to grow our business, and intend to fund our current operations and anticipated growth from the cash flow generated from our operations and our retained earnings. However, these sources may not be sufficient to meet our needs. We may not be able to obtain financing on commercially reasonable terms, or at all.

If additional financing is not available when required or is not available on acceptable terms, we may be unable to fund our expansion, successfully promote our brand name, develop or enhance our products and services, take advantage of business opportunities, or respond to competitive pressures, any of which could have a material adverse effect on our business.

If we choose to raise additional funds through the issuance of equity securities, you may experience significant dilution of your ownership interest, and holders of the additional equity securities may have rights senior to those of the holders of our common stock. If we obtain additional financing by issuing debt securities, the terms of these securities could restrict or prevent us from paying dividends and could limit our flexibility in making business decisions.

***Our business may be sensitive to recessions.***

The demand for online advertising may be linked to the level of economic activity and employment in the U.S. and abroad. Specifically, our business is dependent on the demand for online advertising from travel companies. The last recession decreased consumer travel and caused travel companies to reduce or postpone their marketing spending generally, and their online marketing spending in particular. In case of another recession, our business and financial condition could be materially adversely affected.

***Our operations could be significantly hindered by the occurrence of a natural disaster or other catastrophic event.***

Our operations are susceptible to outages due to fire, floods, power loss, telecommunications failures, break-ins and similar events. In addition, a significant portion of our network infrastructure is located in Northern California, an area susceptible to earthquakes. We do not have multiple site capacity in the event of any such occurrence. Outages could cause significant interruptions of our service. In addition, despite our implementation of network security measures, our servers are vulnerable to computer viruses, physical and electronic break-ins, and similar disruptions from unauthorized tampering with our computer systems. We do not carry business interruption insurance to compensate us for losses that may occur as a result of any of these events.



**Table of Contents**

***Technological or other assaults on our service could harm our business.***

We are vulnerable to coordinated attempts to overload our systems with data, which could result in denial or reduction of service to some or all of our users for a period of time. We have experienced denial of service attacks in the past, and may experience such attempts in the future. Any such event could reduce our revenue and harm our operating results and financial condition. We do not carry business interruption insurance to compensate us for losses that may occur as a result of any of these events.

**Risks Related to Our Markets and Strategy**

***Our international expansion is expected to result in substantial operating losses, and is subject to other material risks.***

In May 2005, we began operations in the U.K. In 2006, we began operations in Canada, Germany and Spain. In 2007, we began operations in Australia, China, France, Hong Kong, Japan, and Taiwan. Our plan is to expand into additional countries in Asia Pacific and Europe in the future. We expect our operations in Asia Pacific and Europe will incur significant losses in the next two to three years primarily as a result of significant expenses related to subscriber acquisition and other marketing activities. These losses may not have any recognizable tax benefit. We expect that this will have a material negative impact on our operating margins and net income. It is likely that we will not sustain profitability in 2008. Any of these developments could result in a significant decrease in the trading price of our common stock. In addition to uncertainty about our ability to generate net income from our foreign operations and expand our international market position, there are certain risks inherent in doing business internationally, including:

trade barriers and changes in trade regulations;

difficulties in developing, staffing and simultaneously managing foreign operations as a result of distance, language and cultural differences;

stringent local labor laws and regulations;

currency exchange rate fluctuations;

risks related to government regulation; and

potentially adverse tax consequences.

***We may not be able to continue developing awareness of our brand name.***

We believe that continuing to build awareness of the *Travelzoo* brand name is critical to achieving widespread acceptance of our business. Brand recognition is a key differentiating factor among providers of online advertising opportunities, and we believe it could become more important as competition in our industry increases. In order to maintain and build brand awareness, we must succeed in our marketing efforts. If we fail to successfully promote and maintain our brand, incur significant expenses in promoting our brand and fail to generate a corresponding increase in revenue as a result of our branding efforts, or encounter legal obstacles which prevent our continued use of our brand name, our business could be materially adversely affected.

***Our business may be sensitive to events affecting the travel industry in general.***

Events like the war with Iraq or the terrorist attacks on the U.S. in 2001 have a negative impact on the travel industry. We are not in a position to evaluate the net effect of these circumstances on our business. In the longer term, our business might be negatively affected by financial pressures on the travel industry. However, our business may also benefit if travel companies increase their efforts to promote special offers or other marketing programs. If such events result in a long-term negative impact on the travel industry, such impact could have a material adverse effect on our business.

**Table of Contents**

***We will not be able to attract travel companies or Internet users if we do not continually enhance and develop the content and features of our products and services.***

To remain competitive, we must continually improve the responsiveness, functionality and features of our products and services. We may not succeed in developing features, functions, products or services that travel companies and Internet users find attractive. This could reduce the number of travel companies and Internet users using our products and materially adversely affect our business.

***We may lose business if we fail to keep pace with rapidly changing technologies and clients' needs.***

Our success is dependent on our ability to develop new and enhanced software, services and related products to meet rapidly evolving technological requirements for online advertising. Our current technology may not meet the future technical requirements of travel companies. Trends that could have a critical impact on our success include:

rapidly changing technology in online advertising;

evolving industry standards, including both formal and *de facto* standards relating to online advertising;

developments and changes relating to the Internet;

competing products and services that offer increased functionality; and

changes in travel company and Internet user requirements.

If we are unable to timely and successfully develop and introduce new products and enhancements to existing products in response to our industry's changing technological requirements, our business could be materially adversely affected.

***Our business and growth will suffer if we are unable to hire and retain highly skilled personnel.***

Our future success depends on our ability to attract, train, motivate and retain highly skilled employees. We may be unable to retain our skilled employees, or attract, assimilate and retain other highly skilled employees in the future. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we are unable to hire and retain skilled personnel, our growth may be restricted, which could adversely affect our future success.

***We may not be able to effectively manage our expanding operations.***

Since the commencement of our operations, we have experienced a period of rapid growth. In order to execute our business plan, we must continue to grow significantly. As of June 30, 2008, we had 191 employees. We expect that the number of our employees will continue to increase for the foreseeable future. This growth has placed, and our anticipated future growth will continue to place, a significant strain on our management, systems and resources. We expect that we will need to continue to improve our financial and managerial controls and reporting systems and procedures. We will also need to continue to expand and maintain close coordination among our sales, production, marketing, IT and finance departments. We may not succeed in these efforts. Our inability to expand our operations in an efficient manner could cause our expenses to grow disproportionately to revenues, our revenues to decline or grow more slowly than expected and could otherwise have a material adverse effect on our business.

***Intense competition may adversely affect our ability to achieve or maintain market share and operate profitably.***

We face intense competition. We compete for advertising dollars with large Internet portal sites, such as America Online, MSN and Yahoo!, that offer listings or other advertising opportunities for travel companies. These companies have significantly greater financial, technical, marketing and other resources and larger client bases. We compete with search engines like Google and Yahoo! Search that offer pay-per-click listings. We also compete with travel meta-search engines and online travel deal publishers. We also compete with large online travel agencies like Expedia and Priceline that also offer advertising placements. In addition, we compete with newspapers, magazines and other traditional media companies that operate Web sites which provide online advertising opportunities. We expect to face additional competition as other established and emerging companies, including print media companies, enter the online advertising



**Table of Contents**

market. Competition could result in reduced margins on our services, loss of market share or less use of *Travelzoo* by travel companies and consumers. If we are not able to compete effectively with current or future competitors as a result of these and other factors, our business could be materially adversely affected.

***Loss of any of our key management personnel could negatively impact our business.***

Our future success depends to a significant extent on the continued service and coordination of our management team, particularly Ralph Bartel, our Chairman, President, and Chief Executive Officer. The loss or departure of any of our officers or key employees could materially adversely affect our ability to implement our business plan. We do not maintain key person life insurance for any member of our management team. In addition, we expect new members to join our management team in the future. These individuals will not previously have worked together and will be required to become integrated into our management team. If our key management personnel are not able to work together effectively or successfully, our business could be materially adversely affected.

***We may not be able to access third party technology upon which we depend.***

We use technology and software products from third parties including Microsoft. Technology from our current or other vendors may not continue to be available to us on commercially reasonable terms, or at all. Our business will suffer if we are unable to access this technology, to gain access to additional products or to integrate new technology with our existing systems. This could cause delays in our development and introduction of new services and related products or enhancements of existing products until equivalent or replacement technology can be accessed, if available, or developed internally, if feasible. If we experience these delays, our business could be materially adversely affected.

**Risks Related to the Market for our Shares**

***Our stock price has been volatile historically and may continue to be volatile.***

The trading price of our common stock has been and may continue to be subject to wide fluctuations. During the six month period ended June 30, 2008, the sales price of our common stock on the NASDAQ Stock Market ranged from \$8.57 to \$17.20. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results; announcements of technological innovations or new products by us or our competitors; changes in financial estimates and recommendations by securities analysts; the operating and stock price performance of other companies that investors may deem comparable to us; and news reports relating to trends in our markets or general economic conditions.

In addition, the stock market in general, and the market prices for Internet-related companies in particular, have experienced volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the price of our stock, regardless of our operating performance.

***We are controlled by a principal stockholder.***

Ralph Bartel, who founded Travelzoo and who is our Chairman of the Board, President, and Chief Executive Officer, is our largest stockholder, holding beneficially, as of August 5, 2008, approximately 56.9% of our outstanding shares with options to increase his percentage ownership to 62.5% on a fully-diluted basis. Through his share ownership, he is in a position to control Travelzoo and to elect our entire board of directors.

**Table of Contents**

**Risks Related to Legal Uncertainty**

***We may become subject to burdensome government regulations and legal uncertainties affecting the Internet which could adversely affect our business.***

To date, governmental regulations have not materially restricted use of the Internet in our markets. However, the legal and regulatory environment that pertains to the Internet is uncertain and may change. Uncertainty and new regulations could increase our costs of doing business, prevent us from delivering our products and services over the Internet or slow the growth of the Internet. In addition to new laws and regulations being adopted, existing laws may be applied to the Internet. New and existing laws may cover issues which include:

- user privacy;
- anti-spam legislation;
- consumer protection;
- copyright, trademark and patent infringement;
- pricing controls;
- characteristics and quality of products and services;
- sales and other taxes; and

other claims based on the nature and content of Internet materials.

***We may be liable as a result of information retrieved from or transmitted over the Internet.***

We may be sued for defamation, negligence, copyright or trademark infringement or other legal claims relating to information that is published or made available in our products. These types of claims have been brought, sometimes successfully, against online services in the past. The fact that we distribute information via e-mail may subject us to potential risks, such as liabilities or claims resulting from unsolicited e-mail or spamming, lost or misdirected messages, security breaches, illegal or fraudulent use of e-mail or interruptions or delays in e-mail service. In addition, we could incur significant costs in investigating and defending such claims, even if we ultimately are not liable. If any of these events occur, our business could be materially adversely affected.

***Claims may be asserted against us relating to shares not issued in our 2002 merger.***

The merger of Travelzoo.com Corporation into the Company became effective on April 25, 2002. Stockholders of Travelzoo.com Corporation were allowed a period of two years following the effective date to receive shares in the Company. After April 25, 2004, two years following the effective date, we ceased issuing shares to the former stockholders of Travelzoo.com Corporation. Many of the Netsurfer stockholders, who had applied to receive shares of Travelzoo.com Corporation in 1998 for no cash consideration, did not elect to receive their shares which were issuable in the merger prior to the end of the two-year period. A total of 4,115,532 of our shares which had been reserved for issuance in the merger were not claimed.

It is possible that claims may be asserted against us in the future by former stockholders of Travelzoo.com Corporation seeking to receive our shares, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares under escheat statutes. If such escheat claims are asserted, we intend to challenge the applicability of escheat rights in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met

the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, we intend to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. We also expect to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that we are not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, we would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. We are not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in us being required to issue up to an additional 4,069,000 shares of common stock for no additional payment, which would result in substantial dilution of the ownership interests of the other stockholders, and in our earnings per share, which could adversely affect the market price of our common stock.

**Table of Contents**

On October 15, 2004, we announced a program under which we would make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$9,000 for these cash payments for the six months ended June 30, 2008. The liability was \$13,000 as of June 30, 2008, including \$5,000 previously accrued as of December 31, 2007. The liability is based on the actual number of valid requests received from former stockholders through June 30, 2008 that remain unpaid. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of our common stock price. Our common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. We do not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but we believe that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding approximately 4,069,000 shares had not submitted claims under the program as of June 30, 2008.

***Our internal controls over financial reporting may not be effective, and our independent auditors may not be able to certify as to the effectiveness of our internal controls, which could have a significant and adverse effect on our business.***

We are obligated to evaluate our internal controls over financial reporting in order to allow management to report on, and our independent auditors to opine on, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the SEC. In our Section 404 evaluation, we have identified areas of internal controls that may need improvement and have instituted remediation efforts where necessary. Currently, none of our identified areas that need improvement have been categorized as material weaknesses. We may identify conditions that may result in significant deficiencies or material weaknesses in the future.

***We may be unable to protect our registered trademark or other proprietary intellectual property rights.***

Our success depends to a significant degree upon the protection of the *Travelzoo* brand name. We rely upon a combination of copyright, trade secret and trademark laws and non-disclosure and other contractual arrangements to protect our intellectual property rights. The steps we have taken to protect our proprietary rights, however, may not be adequate to deter misappropriation of proprietary information.

We have registered the *Travelzoo* trademark in the U.S., Australia, Canada, China, Hong Kong, Japan, South Korea, Taiwan, and the U.K. If we are unable to protect our rights in the mark in North America, Europe and Asia Pacific, a key element of our strategy of promoting *Travelzoo* as a brand could be disrupted and our business could be adversely affected. We may not be able to detect unauthorized use of our proprietary information or take appropriate steps to enforce our intellectual property rights. In addition, the validity, enforceability and scope of protection of intellectual property in Internet-related industries is uncertain and still evolving. The laws of countries in which we may market our services in the future are uncertain and may afford little or no effective protection of our intellectual property. The unauthorized reproduction or other misappropriation of our proprietary technology could enable third parties to benefit from our technology and brand name without paying us for them. If this were to occur, our business could be materially adversely affected.

***We may face liability from intellectual property litigation that could be costly to prosecute or defend and distract management's attention with no assurance of success.***

We cannot be certain that our products, content and brand names do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. While we have a trademark for *Travelzoo*, many companies in the industry have similar names including the word *travel*. We expect that infringement claims in our markets will increase in number as more participants enter the markets. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit, and such claims could result in a significant diversion of the efforts of our management personnel. Successful

infringement claims against us may result in monetary liability or a material disruption in the conduct of our business.



**Table of Contents**

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

We believe that our potential exposure to changes in market interest rates is not material. The Company has no outstanding debt and is not a party to any derivatives transactions. We invest in highly liquid investments with short maturities. Accordingly, we do not expect any material loss from these investments.

Our operations in Asia Pacific expose us to foreign currency risk associated with agreements being denominated in Australian Dollars, Chinese Yuan, Hong Kong Dollars, Japanese Yen, and Taiwan Dollars. Our operations in Canada expose us to foreign currency risk associated with agreements being denominated in Canadian Dollars. Our operations in Europe expose us to foreign currency risk associated with agreements being denominated in British Sterling Pounds and Euros. We are exposed to foreign currency risk associated with fluctuations of these currencies as the financial position and operating results of our operations in Asia Pacific, Canada and Europe will be translated into U.S. Dollars for consolidation purposes. We do not use derivative instruments to hedge these exposures.

**Item 4. *Controls and Procedures***

As of June 30, 2008, we carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in this quarterly report was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and were also effective to ensure that information required to be disclosed by us in this quarterly report was accumulated and communicated to our management including the Company's President and Chief Executive Officer and the Company's Chief Financial Officer to allow timely decisions regarding its disclosure.

During the three months ended June 30, 2008, there was no change in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1A. *Risk Factors***

An updated description of the risk factors associated with our business is included under "Risk Factors" in Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in Item 2 of Part I of this report. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our 2007 Annual Report on Form 10-K and is incorporated herein by reference.

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

There were no unregistered sales of equity securities during the period covered by this report.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

The annual meeting of stockholders occurred on June 3, 2008, at which the following individuals were elected as directors: Ralph Bartel, Holger Bartel, David J. Ehrlich, Donovan Neale-May, and Kelly M. Urso.

The stockholders voted as follows:

| Proposal              | For        | Withhold or Abstain |
|-----------------------|------------|---------------------|
| Election of Directors |            |                     |
| Ralph Bartel          | 10,520,386 | 1,734,293           |
| Holger Bartel         | 10,585,013 | 1,669,656           |
| David J. Ehrlich      | 12,081,839 | 172,840             |
| Donovan Neale-May     | 12,139,694 | 114,985             |
| Kelly M. Urso         | 12,135,597 | 119,072             |

**Item 6. Exhibits**

The following table sets forth a list of exhibits:

| Exhibit Number | Description  |
|----------------|--|
| 3.1            | Certificate of Incorporation of Travelzoo Inc. (Incorporated by reference to our Pre-Effective Amendment No. 6 to Registration Statement on Form S-4 (File No. 333-55026), filed February 14, 2002). |
| 3.2            | By-laws of Travelzoo Inc. (Incorporated by reference to Pre-Effective Amendment No. 6 to our Registration Statement on Form S-4 (File No. 333-55026), filed February 14, 2002).                      |
| 31.1           | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.   |
| 31.2           | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.   |
| 32.1           | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2           | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

Filed herewith

Furnished  
herewith

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TRAVELZOO INC.  
(Registrant)

By: /s/ Wayne Lee

Wayne Lee  
*Chief Financial Officer*  
*(Principal Financial Officer and Authorized Signatory)*

Date: August 11, 2008