TRAVELZOO INC
Form 10-Q
May 10, 2007

Table of Contents

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

(Mark One)

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

For the quarterly period ended March 31, 2007

or

o **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	**36-4415727**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. employer identification no.)*
590 Madison Avenue, 21st Floor, New York, New York	**10022**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code: **(212) 521-4200**

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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The number of shares of Travelzoo common stock outstanding as of May 1, 2007 was 15,250,479 shares.

TRAVELZOO INC.
Table of Contents

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)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,889	$ 33,415
Accounts receivable, less allowance for doubtful accounts of $740 and $726 as of March 31, 2007 and December 31, 2006, respectively	9,220	7,274
Deposits	295	177
Prepaid expenses and other current assets	941	506
Deferred income taxes	1,980	1,980
Total current assets	52,325	43,352
Deposits, less current portion	107	142
Property and equipment, net	219	172
Intangible assets, net	32	34
Total assets	$ 52,683	$ 43,700
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,285	$ 2,839
Accrued expenses	2,633	2,149
Deferred revenue	774	750
Income tax payable	2,974	1,142
Total liabilities	10,666	6,880
Other liabilities	1,148	3
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.01 par value (40,000 shares authorized; 15,250 shares issued and outstanding as of March 31, 2007 and December 31, 2006)	153	153
Additional paid-in capital	2,076	2,076
Retained earnings	38,629	34,566
Accumulated other comprehensive income	11	22
Total stockholders equity	40,869	36,817

Total liabilities and stockholders equity	$	52,683	$	43,700

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

TRAVELZOO INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenues	$ 19,740	$ 16,928
Cost of revenues	353	264
Gross profit	19,387	16,664
Operating expenses:		
Sales and marketing	9,317	7,099
General and administrative	2,593	2,601
Total operating expenses	11,910	9,700
Income from operations	7,477	6,964
Interest income	364	344
Loss on foreign currency	(1)	(7)
Income before income tax expense	7,840	7,301
Income tax expense	3,777	3,185
Net income	$ 4,063	$ 4,116
Basic net income per share	$ 0.27	$ 0.26
Diluted net income per share	$ 0.25	$ 0.24
Shares used in computing basic net income per share	15,250	16,103
Shares used in computing diluted net income per share	16,480	17,298

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cash flows from operating activities:		
Net income	$ 4,063	$ 4,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31	33
Provision for losses on accounts receivable	28	247
Accrued income for short-term investments		(166)
Changes in operating assets and liabilities:		
Accounts receivable	(1,971)	(246)
Deposits	(83)	(3)
Prepaid expenses and other current assets	(434)	(243)
Accounts payable	1,444	115
Accrued expenses	481	(156)
Deferred revenue	24	333
Income tax payable	1,832	1,760
Other liabilities	1,145	
Net cash provided by operating activities	6,560	5,790
Cash flows from investing activities:		
Purchases of property and equipment	(77)	(56)
Purchase of short-term investments		(14,663)
Sale of short-term investments		20,000
Net cash provided by (used in) investing activities	(77)	5,281
Cash flows from financing activities:		
Repurchase of common stock		(8,594)
Net cash used in financing activities		(8,594)
Effect of exchange rate changes on cash and cash equivalents	(9)	(4)
Net increase in cash and cash equivalents	6,474	2,473
Cash and cash equivalents at beginning of period	33,415	24,469
Cash and cash equivalents at end of period	$ 39,889	$ 26,942
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds received	$ 800	$ 1,425

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 an Internet media company. Travelzoo s products include the *Travelzoo* Web sites (which includes www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, among others), the *Travelzoo Top 20* e-mail newsletter, the *Newsflash* e-mail product, and the *SuperSearch* pay-per-click travel search engine.

Travelzoo is controlled by Ralph Bartel, who held beneficially approximately 50.2% of the outstanding shares as of May 1, 2007.

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, 2006, included in the Company s Form 10-K filed with the SEC on March 15, 2007.

The 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 ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007 or any other future period, and the Company makes no representations related thereto.

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 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 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

Table of Contents

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 March 31, 2007, there were 15,250,479 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 4,072,000 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 consolidated financial statements include a charge in general and administrative expenses of $43,000 for these cash payments for the three months ended March 31, 2007 of which $4,000 remains as a liability as of March 31, 2007. The liability is based on the number of actual requests received from former stockholders through March 31, 2007 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 4,072,000 shares had not submitted claims under the program as of March 31, 2007.

The merger of Travelzoo.com Corporation into Travelzoo Inc. 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 Travelzoo.com Corporation and Travelzoo Inc. were carried forward 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 Travelzoo.com Corporation. The restated results of operations and cash flows of Travelzoo Inc. are identical to the combined results of Travelzoo.com Corporation and Travelzoo Inc.

Table of Contents

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 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 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.

Table of Contents

Note 3: Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN 48 on January 1, 2007. See Note 7: Income Taxes for a discussion of the impact of FIN 48.

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. This statement is effective for us beginning January 1, 2008. We are currently evaluating the impact of adopting SFAS 159 on our financial statements.

Note 4: Stock-based Compensation

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payments (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. SFAS 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and instead generally requires that such transactions be accounted for using a fair-value based method. The Company has elected the modified prospective transition method as permitted under SFAS 123R, and accordingly prior periods have not been restated to reflect the impact of SFAS 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006. 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.

Prior to the adoption of SFAS 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Condensed Consolidated Statements of Cash Flows. SFAS 123R requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be reclassified as financing cash flows. In the three months ended March 31, 2007, no excess tax benefit was recorded.

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 March 31, 2007, and expire in January 2011.

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 and 17,275 options were exercised during the years ended December 31, 2004 and 2005, respectively. As of March 31, 2007, 42,725 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 of these options were exercised during the year ended December 31, 2004. As of March 31, 2007, 10,000 options are vested and remain outstanding.

The Company did not provide any stock-based compensation in fiscal years 2005, 2006, or in the three months ended March 31, 2007. In addition, all previously issued options vested prior to January 1, 2002.

Option activity as of March 31, 2007 and changes during the three months ended March 31, 2007 were as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2006	2,211,074	$1.03		
Outstanding at March 31, 2007	2,211,074	$1.03	3.86 years	$ 79,027
Exercisable and fully vested at March 31, 2007	2,211,074	$1.03	3.86 years	$ 79,027

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 first quarter of fiscal 2007 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 March 31, 2007. This amount changes based on the fair market value of the Company s stock. The Company s policy is to issue shares from the authorized shares to fulfill stock option exercises.

Note 5: Net Income Per Share

Net income per share has been calculated in accordance with SFAS No. 128, Earnings per Share. Basic net income per share is computed using the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by adjusting the weighted-average number of common shares outstanding for the effect of 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.

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Basic net income per share:		
Net income	$ 4,063	$ 4,116
Weighted average common shares	15,250	16,103
Basic net income per share	$ 0.27	$ 0.26
Diluted net income per share:		
Net income	$ 4,063	$ 4,116
Weighted average common shares	15,250	16,103
Effect of dilutive securities: stock options	1,230	1,195
Diluted weighted average common shares	16,480	17,298
Diluted net income per share	$ 0.25	$ 0.24

Note 6: Commitments and Contingencies

The Company leases office space in Canada, France, Germany, Hong Kong, Spain, the U.K., and the U.S. under operating leases which expire between December 31, 2007 and December 31, 2009. The future minimum lease payments under these operating leases as of March 31, 2007 total $3,448,000. The future lease payments consist of $1,835,000 due in 2007, $1,165,000 due in 2008, and $448,000 due in 2009.

Table of Contents

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 4,072,000 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 consolidated financial statements included a charge in general and administrative expenses of $43,000 for these cash payments for the three months ended March 31, 2007 of which $4,000 remains as a liability as of March 31, 2007. The liability is based on the number of actual 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 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 4,072,000 shares had not submitted claims under the program.

As a result of the adoption of FIN 48, the total liability for uncertain tax positions is $1.0 million (see Note 7). The Company is not able to make reasonably reliable estimates of the timing of cash settlements with the respective taxing authorities.

Note 7: Income Taxes

We adopted the provisions of FIN 48, on January 1, 2007. The adoption of FIN 48 did not result in a cumulative effect adjustment to retained earnings as of January 1, 2007. The Company has a liability of $1.0 million for income taxes associated with uncertain tax positions at January 1, 2007. The net amount of $1.0 million, if recognized, would favorably affect the company s effective tax rate. In addition, consistent with the provisions of FIN 48, the company reclassified $1.0 million of income tax liabilities from income taxes payable to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date. These non-current income tax liabilities are recorded in other liabilities in the Condensed Consolidated Balance Sheets.

Interest and penalties related to income tax liabilities are included in income tax expense. The balance of accrued interest and penalties recorded in the Condensed Consolidated Balance Sheets at January 1, 2007 was $97,000; of this amount, $97,000 was also reclassified from income taxes payable to other liabilities upon adoption of FIN 48.

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. We are no longer subject to U.S. federal and certain tax examinations for years before 2003. We are no longer subject to California tax examinations for years before 2002. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months.

Note 8: Segment Reporting and Significant Customer Information

The Company manages its business geographically and has two operating segments: North America and Europe. North America consists of the Company s operations in the U.S. and Canada. Europe consists of the Company s operations in the U.K., Germany, Spain, and France. The Company began operations in Europe in May 2005.

Table of Contents

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:

Three months ended March 31, 2007:	North America	Europe	Elimination	Consolidated
Revenues from unaffiliated customers	$ 18,454	$ 1,286	$	$ 19,740
Intersegment revenues	42	3	(45)	
Total net revenues	18,496	1,289	(45)	$ 19,740
Operating income (loss)	8,159	(683)	1	7,477

Three months ended March 31, 2006:	North America	Europe	Elimination	Consolidated
Revenues from unaffiliated customers	$ 16,365	$ 563	$	$ 16,928
Intersegment revenues	71	2	(73)	
Total net revenues	16,436	565	(73)	16,928
Operating income (loss)	7,424	(460)		6,964

As of March 31, 2007	North America	Europe	Elimination	Consolidated
Property and equipment, net:	$ 159	$ 60	$	$ 219
Total assets	55,403	2,674	(5,394)	52,683

As of December 31, 2006	North America	Europe	Elimination	Consolidated
Property and equipment, net:	$ 126	$ 46	$	$ 172
Total assets	45,922	3,093	(5,315)	43,700

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:

	Percent of Revenues		**Percent of Accounts Receivable**	
	Three Months Ended March 31,		**March 31,**	**December 31,**
Customer	**2007**	**2006**	**2007**	**2006**
Travelport Limited	14%	14%	20%	16%
Expedia, Inc.	12%	12%	22%	16%

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 9: Comprehensive Income

Comprehensive income consists of two components: net income and other comprehensive income (loss). Other comprehensive income (loss) refers to gains and losses that under generally accepted accounting principles are recorded as an element of stockholders equity but are excluded from net income. The Company s other comprehensive income (loss) is comprised of foreign currency translation adjustments.

Note 10: 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.

Note 11: Subsequent Events

On April 26, 2007, the board of directors authorized the repurchase of up to 1 million shares of the Company s outstanding common stock.

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 , int 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 an 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 include the *Travelzoo* Web sites (which includes www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, among others), the *Travelzoo Top 20* e-mail newsletter, and the *Newsflash* e-mail product. We also operate *SuperSearch*, a pay-per-click travel search engine. More than 600 travel companies purchase our advertising services.

Our revenues are advertising revenues, consisting of listing fees paid 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 product, and in *SuperSearch*, a pay-per-click travel search engine. 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 $4,000 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 two operating segments based on geographic regions: North America and Europe. North America consists of our operations in the U.S. and Canada. Europe consists of our operations in the U.K., Germany, Spain, and France.

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;