Expedia, Inc.
Form 10-Q
October 31, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2014

OR

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

Commission File Number: 000-51447

EXPEDIA, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2705720**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

333 108th Avenue NE

Bellevue, WA 98004

(Address of principal executive office) (Zip Code)

(425) 679-7200

(Registrant s telephone number, including area code)

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The number of shares outstanding of each of the registrant s classes of common stock as of October 17, 2014 was:

Common stock, $0.0001 par value per share	113,747,967 shares
Class B common stock, $0.0001 par value per share	12,799,999 shares

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Expedia, Inc.

Form 10-Q

For the Quarter Ended September 30, 2014

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Part I. Item 1. Consolidated Financial Statements

EXPEDIA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except for per share data)

(Unaudited)

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Revenue	$ 1,712,504	$ 1,401,860	$ 4,407,507	$ 3,619,244
Costs and expenses:				
Cost of revenue (1)	299,708	276,318	894,828	789,506
Selling and marketing (1)	815,800	625,296	2,184,115	1,711,919
Technology and content (1)	172,754	143,816	504,804	422,781
General and administrative (1)	104,999	92,351	306,584	276,618
Amortization of intangible assets	18,519	18,514	55,275	49,921
Legal reserves, occupancy tax and other	3,888	6,874	38,843	74,678
Acquisition-related and other (1)				66,472
Operating income	296,836	238,691	423,058	227,349
Other income (expense):				
Interest income	8,075	6,642	20,756	19,837
Interest expense	(25,558)	(21,966)	(69,683)	(65,343)
Other, net	10,172	(11,287)	2,514	(1,611)
Total other expense, net	(7,311)	(26,611)	(46,413)	(47,117)
Income before income taxes	289,525	212,080	376,645	180,232
Provision for income taxes	(38,904)	(45,356)	(59,974)	(57,861)
Net income	250,621	166,724	316,671	122,371
Net loss attributable to noncontrolling interests	6,438	4,135	15,457	15,762
Net income attributable to Expedia, Inc.	$ 257,059	$ 170,859	$ 332,128	$ 138,133
Earnings per share attributable to Expedia, Inc. available to common stockholders:				
Basic	$ 2.01	$ 1.25	$ 2.57	$ 1.01
Diluted	1.94	1.22	2.48	0.98
Shares used in computing earnings per share:				
Basic	127,911	136,380	129,326	136,381
Diluted	132,274	140,451	133,683	141,202
Dividends declared per common share	$ 0.18	$ 0.15	$ 0.48	$ 0.41
(1) Includes stock-based compensation as follows:				
Cost of revenue	$ 1,045	$ 887	$ 3,190	$ 2,712
Selling and marketing	3,643	3,943	13,798	11,857
Technology and content	7,374	5,372	17,892	15,459
General and administrative	10,242	7,837	33,259	22,532

Acquisition-related and other	56,643

See accompanying notes.

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EXPEDIA, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 250,621	$ 166,724	$ 316,671	$ 122,371
Other comprehensive income (loss), net of tax				
Currency translation adjustments	(77,800)	25,874	(57,663)	12,843
Unrealized gains (losses) on available for sale securities, net of taxes [1]	(356)	349	(44)	(1,224)
Other comprehensive income (loss), net of tax	(78,156)	26,223	(57,707)	11,619
Comprehensive income	172,465	192,947	258,964	133,990
Less: Comprehensive income (loss) attributable to noncontrolling interests	(27,754)	(3,715)	(23,932)	(13,310)
Comprehensive income attributable to Expedia, Inc.	$ 200,219	$ 196,662	$ 282,896	$ 147,300

[1] Net gains (losses) recognized and reclassified during the three and nine months ended September 30, 2014 and 2013 were immaterial.

See accompanying notes.

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EXPEDIA, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,252,748	$ 1,021,033
Restricted cash and cash equivalents	31,794	26,042
Short-term investments	396,041	325,510
Accounts receivable, net of allowance of $13,430 and $11,555	887,436	614,735
Deferred income taxes	97,541	66,130
Income taxes receivable	19,545	64,296
Prepaid expenses and other current assets	151,713	101,541
Total current assets	3,836,818	2,219,287
Property and equipment, net	525,053	480,702
Long-term investments and other assets	298,396	250,626
Deferred income taxes	18,196	14,151
Intangible assets, net	1,076,780	1,111,041
Goodwill	3,669,745	3,663,674
TOTAL ASSETS	$ 9,424,988	$ 7,739,481
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable, merchant	$ 1,272,709	$ 1,044,259
Accounts payable, other	425,310	261,288
Deferred merchant bookings	2,086,886	1,350,319
Deferred revenue	56,234	39,746
Income taxes payable	31,037	61,874
Accrued expenses and other current liabilities	669,531	536,895
Total current liabilities	4,541,707	3,294,381
Long-term debt	1,746,712	1,249,412
Deferred income taxes	446,922	433,532
Other long-term liabilities	167,325	138,300
Commitments and contingencies		
Redeemable noncontrolling interests	520,443	364,871
Stockholders equity:		
Common stock $.0001 par value	20	19
Authorized shares: 1,600,000		
Shares issued: 195,674 and 192,562		
Shares outstanding: 113,729 and 116,886		
Class B common stock $.0001 par value	1	1
Authorized shares: 400,000		
Shares issued and outstanding: 12,800 and 12,800		
Additional paid-in capital	5,818,942	5,802,140
Treasury stock Common stock, at cost	(3,934,942)	(3,465,675)
Shares: 81,945 and 75,676		
Retained earnings (deficit)	31,802	(209,218)

Accumulated other comprehensive income (loss)	(31,035)	18,197
Total Expedia, Inc. stockholders equity	1,884,788	2,145,464
Non-redeemable noncontrolling interest	117,091	113,521
Total stockholders equity	2,001,879	2,258,985
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 9,424,988	$ 7,739,481

See accompanying notes.

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EXPEDIA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Operating activities:		
Net income	$ 316,671	$ 122,371
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment, including internal-use software and website development	195,161	152,970
Amortization of stock-based compensation	68,139	109,203
Amortization of intangible assets	55,275	49,921
Deferred income taxes	(27,371)	2,863
Foreign exchange (gain) loss on cash, cash equivalents and short-term investments, net	44,484	53,199
Realized (gain) loss on foreign currency forwards	11,267	(40,228)
Other	4,919	8,772
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(277,056)	(210,118)
Prepaid expenses and other current assets	(55,810)	(14,226)
Accounts payable, merchant	226,362	257,016
Accounts payable, other, accrued expenses and other current liabilities	289,525	(49,299)
Taxes payable/receivable, net	3,704	(31,745)
Deferred merchant bookings	694,830	547,988
Deferred revenue	16,702	16,728
Net cash provided by operating activities from continuing operations	1,566,802	975,415
Investing activities:		
Capital expenditures, including internal-use software and website development	(239,678)	(235,416)
Purchases of investments	(1,044,665)	(1,139,157)
Sales and maturities of investments	957,347	1,338,062
Acquisitions, net of cash acquired	(25,177)	(540,489)
Net settlement of foreign currency forwards	(11,267)	40,228
Other, net	2,188	(177)
Net cash used in investing activities from continuing operations	(361,252)	(536,949)
Financing activities:		
Proceeds from issuance of long-term debt, net of issuance costs	493,630	
Purchases of treasury stock	(469,267)	(355,689)
Proceeds from issuance of treasury stock		25,273
Payment of dividends to stockholders	(61,777)	(56,080)
Proceeds from exercise of equity awards and employee stock purchase plan	79,490	42,693
Excess tax benefit on equity awards	38,352	33,368
Other, net	(1,591)	(9,920)
Net cash provided by (used in) financing activities from continuing operations	78,837	(320,355)
Net cash provided by continuing operations	1,284,387	118,111

Net cash provided by discontinued operations		13,637
Effect of exchange rate changes on cash and cash equivalents	(52,672)	(30,411)
Net increase in cash and cash equivalents	1,231,715	101,337
Cash and cash equivalents at beginning of period	1,021,033	1,293,161
Cash and cash equivalents at end of period	$ 2,252,748	$ 1,394,498
Supplemental cash flow information		
Cash paid for interest from continuing operations	$ 86,349	$ 83,659
Income tax payments, net from continuing operations	42,428	52,550

See accompanying notes.

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Notes to Consolidated Financial Statements

September 30, 2014

(Unaudited)

Note 1 Basis of Presentation

Description of Business

Expedia, Inc. and its subsidiaries provide travel products and services to leisure and corporate travelers in the United States and abroad as well as various media and advertising offerings to travel and non-travel advertisers. These travel products and services are offered through a diversified portfolio of brands including: Expedia.com®, Hotels.com®, Hotwire.com , Expedia® Affiliate Network, Classic Vacations, Expedia Local Expert, Egencia , Expedia® CruiseShipCenters®, eLong , Inc. (eLong), Venere Net SpA (Venere) and trivago GmbH (trivago). In addition, many of these brands have related international points of sale. We refer to Expedia, Inc. and its subsidiaries collectively as Expedia, the Company, us, we and our in these consolidated financial statements.

Basis of Presentation

These accompanying financial statements present our results of operations, financial position and cash flows on a consolidated basis. The unaudited consolidated financial statements include Expedia, Inc., our wholly-owned subsidiaries, and entities we control, or in which we have a variable interest and are the primary beneficiary of expected cash profits or losses. We have eliminated significant intercompany transactions and accounts.

Expedia has a variable interest in Travelocity resulting from an exclusive, long-term strategic marketing agreement entered into in the third quarter of 2013 for which we are not the primary beneficiary. Our exposure to loss under this arrangement is primarily commercial in nature, the maximum of which cannot be quantified.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial reporting. We have included all adjustments necessary for a fair presentation of the results of the interim period. These adjustments consist of normal recurring items. Our interim unaudited consolidated financial statements are not necessarily indicative of results that may be expected for any other interim period or for the full year. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2013, previously filed with the Securities and Exchange Commission.

Accounting Estimates

We use estimates and assumptions in the preparation of our interim unaudited consolidated financial statements in accordance with GAAP. Our estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of our interim unaudited consolidated financial statements. These estimates and assumptions also affect the reported amount of net income or loss during any period. Our actual financial results could differ significantly from these estimates. The significant estimates underlying our interim unaudited consolidated financial statements include revenue recognition; recoverability of current and long-lived assets, intangible assets and goodwill; income and transactional taxes, such as potential settlements related to occupancy and excise taxes; loss contingencies; loyalty program liabilities; redeemable noncontrolling interests; stock-based compensation and accounting for derivative instruments.

Reclassifications

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

Seasonality

We generally experience seasonal fluctuations in the demand for our travel products and services. For example,

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Notes to Consolidated Financial Statements (Continued)

traditional leisure travel bookings are generally the highest in the first three quarters as travelers plan and book their spring, summer and holiday travel. The number of bookings typically decreases in the fourth quarter. Because revenue for most of our travel products, including merchant and agency hotel, is recognized when the travel takes place rather than when it is booked, revenue typically lags bookings by several weeks or longer. The seasonal revenue impact is exacerbated with respect to income by the nature of our variable cost of revenue and direct sales and marketing costs, which we typically realize in closer alignment to booking volumes, and the more stable nature of our fixed costs. Furthermore, operating profits for our primary advertising business, trivago, are experienced in the second half of the year as selling and marketing costs offset revenue in the first half of the year as we aggressively market during the busy booking period for summer travel. As a result, revenue and income are typically the lowest in the first quarter and highest in the third quarter.

Note 2 Summary of Significant Accounting Policies

Recent Accounting Policies Not Yet Adopted

In May 2014, the Financial Accounting Standards Board issued new guidance on revenue from contracts with customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, the new guidance specifies the accounting for some costs to obtain or fulfill a contract with a customer. The update requires an entity to apply the new guidance in one of two methods: (1) retrospectively to each prior reporting period presented, or (2) retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. The new guidance will be effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. We are in the process of evaluating the impact of the adoption of this new guidance on our consolidated financial statements.

Note 3 Acquisitions

On July 29, 2014, we acquired a leading online car rental reservation company in Europe for a total purchase price of $66 million, which was paid in cash during the third quarter of 2014. As a result of this acquisition, we acquired net liabilities of $12 million, including cash of $41 million, as well as recorded deferred tax liabilities of $13 million, $52 million in goodwill and $39 million of intangible assets with definite lives with a weighted average amortization life of 6.4 years.

Business combination accounting is preliminary and subject to revision while we accumulate all relevant information regarding the fair values of net assets acquired, and any change to the fair value of net assets acquired would be expected to lead to a corresponding change to the amount of goodwill recorded on a retroactive basis. The results of operations of the acquired company has been included in our consolidated results from the transaction closing date forward; the effect on consolidated revenue and operating income during the three and nine months ended September 30, 2014 was not significant.

Also, in July 2014, we entered into an agreement to acquire Wotif.com Holdings Limited (Wotif Group), an Australian-based online travel company, for total cash consideration of approximately $703 million Australian dollars or $3.30 Australian dollars per share (approximately $658 million or $3.09 per share based on July 4, 2014 exchange rates), net of certain cash dividends that Wotif Group may distribute to its shareholders before closing. The transaction is expected to close in the fourth quarter of 2014, subject to regulatory approval.

During March 2013, we completed the purchase of a 63% equity position (61.6% on a fully diluted basis) in trivago GmbH, a leading hotel metasearch company based in Germany. In conjunction with the acquisition, we paid 434 million in cash, or approximately $564 million based on March 8, 2013 exchange rates, of which $554 million was paid to the shareholders of trivago and $10 million was used to settle a portion of an employee compensation plan. In addition, we agreed to issue 875,200 shares of Expedia, Inc. common stock to certain employee stockholders in five equal increments on or about each of the first through fifth anniversaries of the acquisition.

As a result of the acquisition, we expensed $66 million to acquisition-related and other on the consolidated statements of operations during quarter ended March 31, 2013, which included approximately $57 million in stock-based compensation

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Notes to Consolidated Financial Statements (Continued)

related to the issuance of the 875,200 shares of common stock as the issuance was determined separate from the business combination and was not contingent upon any future service or other certain event except the passage of time as well as approximately $10 million for the amount paid to settle a portion of the employee compensation plan of trivago, which was considered separate from the business combination. During the first quarter of 2014, we issued the first increment of 175,040 shares of Expedia, Inc. common stock.

The purchase agreement contains certain put/call rights whereby we may acquire and the minority shareholders of trivago may sell to us up to 50% and 100% of the minority shares of the company at fair value during the first quarter of 2016 and 2018, respectively. As the noncontrolling interest is redeemable at the option of the minority holders, we classified the balance as redeemable noncontrolling interest with future changes in the fair value above the initial basis recorded as charges or credits to retained earnings (or additional paid-in capital in absence of retained earnings). The put/call arrangement includes certain rollover provisions that, if triggered, would cause the minority shares to be treated as though they become mandatorily redeemable, and to be reclassified as a liability at the time such trigger becomes certain to occur. For further information on redeemable noncontrolling interest, see Note 6 Redeemable Noncontrolling Interests.

Note 4 Fair Value Measurements

Financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 are classified using the fair value hierarchy in the table below:

	Total	Level 1 (In thousands)	Level 2
Assets			
Cash equivalents:			
Money market funds	$ 226,597	$ 226,597	$
Time deposits	624,539		624,539
Restricted cash:			
Time deposits	16,810		16,810
Derivatives:			
Foreign currency forward contracts	14,028		14,028
Investments:			
Time deposits	369,071		369,071
Corporate debt securities	143,398		143,398
Total assets	$ 1,394,443	$ 226,597	$ 1,167,846

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Notes to Consolidated Financial Statements (Continued)

Financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 are classified using the fair value hierarchy in the table below:

	Total	Level 1 (In thousands)	Level 2
Assets			
Cash equivalents:			
Money market funds	$ 229,425	$ 229,425	$
Time deposits	138,956		138,956
Restricted cash:			
Time deposits	17,085		17,085
Derivatives:			
Foreign currency forward contracts	2,225		2,225
Investments:			
Time deposits	258,308		258,308
Corporate debt securities	200,386		200,386
Total assets	$ 846,385	$ 229,425	$ 616,960

We classify our cash equivalents and investments within Level 1 and Level 2 as we value our cash equivalents and investments using quoted market prices or alternative pricing sources and models utilizing observable market inputs. Valuation of the foreign currency forward contracts is based on foreign currency exchange rates in active markets, a Level 2 input.

As of September 30, 2014 and December 31, 2013, our cash and cash equivalents consisted primarily of prime institutional money market funds with maturities of three months or less, time deposits as well as bank account balances.

We invest in investment grade corporate debt securities, all of which are classified as available for sale. As of September 30, 2014, we had $27 million of short-term and $116 million of long-term available for sale investments and the amortized cost basis of the investments approximated their fair value with both gross unrealized gains and gross unrealized losses of less than $1 million. As of December 31, 2013, we had $67 million of short-term and $133 million of long-term available for sale investments and the amortized cost basis of these investments approximated their fair value with both gross unrealized gains and gross unrealized losses of $1 million.

We also hold time deposit investments with financial institutions. Time deposits with original maturities of less than three months are classified as cash equivalents and those with remaining maturities of less than one year are classified as short-term investments. Additionally, we have time deposits classified as restricted cash to fulfill the requirement of an aviation authority of a certain foreign country to protect against the potential non-delivery of travel services in that country. Of the total time deposit investments, $267 million and $283 million as of September 30, 2014 and December 31, 2013 related to balances held by our majority-owned subsidiaries.

Derivative instruments are carried at fair value on our consolidated balance sheets. We use foreign currency forward contracts to economically hedge certain merchant revenue exposures and in lieu of holding certain foreign currency cash for the purpose of economically hedging our foreign currency-denominated operating liabilities. Our goal in managing our foreign exchange risk is to reduce, to the extent practicable, our potential exposure to the changes that exchange rates might have on our earnings, cash flows and financial position. Our foreign currency forward contracts are typically short-term and, as they do not qualify for hedge accounting treatment, we classify the changes in their fair value in other, net. As of September 30, 2014, we were party to outstanding forward contracts hedging our liability and revenue exposures with a total net notional value of $766 million. We had a net forward asset of $14 million and $2 million as of September 30, 2014 and December 31, 2013 recorded in prepaid expenses and other current assets. We recorded $18 million in net gains and $8 million in net losses from foreign currency forward contracts during the three months ended September 30, 2014 and 2013, and $2 million and $43 million in net gains for the nine months ended September 30, 2014 and 2013.

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Notes to Consolidated Financial Statements (Continued)

Note 5 Debt

The following table sets forth our outstanding debt:

	September 30, 2014	December 31, 2013
	(In thousands)	
7.456% senior notes due 2018	$ 500,000	$ 500,000
5.95% senior notes due 2020, net of discount	749,466	749,412
4.5% senior notes due 2024, net of discount	497,246	
Long-term debt	$ 1,746,712	$ 1,249,412

Long-term Debt

Our $500 million in registered senior unsecured notes outstanding at September 30, 2014 are due in August 2018 and bear interest at 7.456% (the 7.456% Notes). Interest is payable semi-annually in February and August of each year. At any time Expedia may redeem the 7.456% Notes at a redemption price of 100% of the principal plus accrued interest, plus a make-whole premium, in whole or in part.

Our $750 million in registered senior unsecured notes outstanding at September 30, 2014 are due in August 2020 and bear interest at 5.95% (the 5.95% Notes). The 5.95% Notes were issued at 99.893% of par resulting in a discount, which is being amortized over their life. Interest is payable semi-annually in February and August of each year. We may redeem the 5.95% Notes at a redemption price of 100% of the principal plus accrued interest, plus a make-whole premium, in whole or in part.

In August 2014, we registered $500 million of senior unsecured notes that are due in August 2024 and bear interest at 4.5% (the 4.5% Notes). The 4.5% Notes were issued at 99.444% of par resulting in a discount, which is being amortized over their life. Interest is payable semi-annually in February and August of each year, beginning February 15, 2015. We may redeem the 4.5% Notes at our option at any time in whole or from time to time in part. If we elect to redeem the 4.5% Notes prior to May 15, 2024, we may redeem them at a redemption price of 100% of the principal plus accrued interest, plus a make-whole premium. If we elect to redeem the 4.5% Notes on or after May 15, 2024, we may redeem them at a redemption price of 100% of the principal plus accrued interest.

The 7.456%, 5.95% and 4.5% Notes (collectively the Notes) are senior unsecured obligations guaranteed by certain domestic Expedia subsidiaries and rank equally in right of payment with all of our existing and future unsecured and unsubordinated obligations. For further information, see Note 12 Guarantor and Non-Guarantor Supplemental Financial Information. In addition, the Notes include covenants that limit our ability to (i) create certain liens, (ii) enter into sale/leaseback transactions and (iii) merge or consolidate with or into another entity. Accrued interest related to the Notes was $13 million and $31 million as of September 30, 2014 and December 31, 2013.

The approximate fair value of the 7.456% Notes was $587 million as of both September 30, 2014 and December 31, 2013. The approximate fair value of the 5.95% Notes was $848 million and $816 million as of September 30, 2014 and December 31, 2013. The approximate fair value of the 4.5% Notes was $497 million as of September 30, 2014. These fair values were based on quoted market prices in less active markets (Level 2 on the fair value hierarchy).

Credit Facility

Expedia, Inc. maintains a $1 billion unsecured revolving credit facility with a group of lenders, which is unconditionally guaranteed by certain domestic Expedia subsidiaries that are the same as under the Notes. In September 2014, we amended the revolving credit facility to, among other things, extend the maturity date of the facility to September 2019. As of September 30, 2014 and December 31, 2013, we had no revolving credit facility borrowings outstanding. The facility bears interest based on the Company s credit ratings, with drawn amounts bearing interest at LIBOR plus 150 basis points and the commitment fee on undrawn amounts at 20 basis points as of September 30, 2014. The facility contains covenants including maximum leverage and minimum interest coverage ratios.

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Notes to Consolidated Financial Statements (Continued)

The amount of stand-by letters of credit (LOC) issued under the facility reduces the credit amount available. As of September 30, 2014 and December 31, 2013, there was $15 million and $19 million of outstanding stand-by LOCs issued under the facility.

Note 6 Redeemable Noncontrolling Interests

We have noncontrolling interests in a majority owned entity, which is carried at fair market value as the noncontrolling interests contain certain rights, whereby we may acquire and the minority shareholders may sell to us the additional shares of the company.

A reconciliation of redeemable noncontrolling interests is as follows:

	Nine months ended September 30, 2014 (in thousands)
Balance, beginning of the period	$ 364,871
Net loss attributable to noncontrolling interests	(11,739)
Fair value adjustments	190,491
Currency translation adjustments and other	(23,180)
Balance, end of period	$ 520,443

The fair value of the redeemable noncontrolling interest was determined based on a blended analysis of the present value of future discounted cash flows and market value approach (Level 3 on the fair value hierarchy). Our significant estimates in the discounted cash flow model include our weighted average cost of capital as well as long-term growth and profitability of the business. Our significant estimates in the market value approach include identifying similar companies with comparable business factors and assessing comparable revenue and operating multiples in estimating the fair value of the business.

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Note 7 Stockholders Equity

Dividends on our Common Stock

The Executive Committee, acting on behalf of the Board of Directors, declared the following dividends during the periods presented:

Declaration Date	Dividend Per Share	Record Date	Total Amount (in thousands)	Payment Date
Nine months ended September 30, 2014:				
February 5, 2014	$ 0.15	March 10, 2014	$ 19,602	March 27, 2014
April 30, 2014	0.15	May 30, 2014	19,231	June 19, 2014
July 30, 2014	0.18	August 27, 2014	22,944	September 17, 2014
Nine months ended September 30, 2013:				
February 5, 2013	$ 0.13	March 11, 2013	$ 17,983	March 28, 2013
April 24, 2013	0.13	May 30, 2013	17,638	June 19, 2013
July 24, 2013	0.15	August 28, 2013	20,459	September 18, 2013

In addition, on October 27, 2014, the Executive Committee, acting on behalf of the Board of Directors, declared a quarterly cash dividend of $0.18 per share of outstanding common stock payable on December 11, 2014 to stockholders of record as of the close of business on November 20, 2014. Future declarations of dividends are subject to final determination by our Board of Directors.

Share Repurchases

In April 2012, the Executive Committee, acting on behalf of the Board of Directors, authorized a repurchase of up to 20 million outstanding shares of our common stock. There is no fixed termination date for the repurchases. During the nine months ended September 30, 2014, we repurchased, through open market transactions, 6.3 million shares under this authorization for a total cost of $469 million, excluding transaction costs, representing an average repurchase price of $74.83 per share. As of September 30, 2014, 2.5 million shares remain authorized for repurchase under the 2012 authorization. Subsequent to the end of the third quarter of 2014, we repurchased an additional 0.3 million shares for a total cost of $23 million, excluding transaction costs, representing an average purchase price of $86.36 per share.

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Note 8 Earnings Per Share

The following table presents our basic and diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per share data)			
Net income attributable to Expedia, Inc.	$ 257,059	$ 170,859	$ 332,128	$ 138,133
Earnings per share attributable to Expedia, Inc. available to common stockholders:				
Basic	$ 2.01	$ 1.25	$ 2.57	$ 1.01
Diluted	1.94	1.22	2.48	0.98
Weighted average number of shares outstanding:				
Basic	127,911	136,380	129,326	136,381
Dilutive effect of:				
Options to purchase common stock	4,269	3,945	4,247	4,613
Other dilutive securities	94	126	110	208
Diluted	132,274	140,451	133,683	141,202

Basic earnings per share is calculated using our weighted-average outstanding common shares. The earnings per share amounts are the same for common stock and Class B common stock because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

Diluted earnings per share is calculated using our weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method. In periods when we recognize a net loss, we exclude the impact of outstanding stock awards from the diluted loss per share calculation as their inclusion would have an antidilutive effect. For the three and nine months ended September 30, 2014 and 2013, approximately 4 million of outstanding stock awards for all periods have been excluded from the calculations of diluted earnings (loss) per share attributable to common stockholders because their effect would have been antidilutive.

Note 9 Income Taxes

We determine our provision for income taxes for interim periods using an estimate of our annual effective tax rate. We record any changes affecting the estimated annual tax rate in the interim period in which the change occurs, including discrete tax items.

Our effective tax rate was 13.4% and 21.4% for the three months ended September 30, 2014 and 2013, and 15.9% and 32.1% for the nine months ended September 30, 2014 and 2013. The change in the effective rate for the three months ended September 30, 2014 compared to the same period in 2013 was due to expiration of the statute of limitations for the 2001 through 2005 federal tax years and the associated release of liabilities related to uncertain tax positions as described below. The change in the effective rate for the nine months ended September 30, 2014 compared to the same period in 2013 was also impacted by the release of liabilities related to uncertain tax positions in the current period, as well as non-deductible stock-based compensation recorded related to the trivago acquisition and non-deductible penalties included in the Hawaii pay-to-play assessments in 2013.

The Company is routinely under audit by federal, state, local and foreign income tax authorities. These audits include questioning the timing and the amount of income and deductions and the allocation of income and deductions among various tax jurisdictions. The statute of limitations for federal income taxes for the years 2001 through 2005, when Expedia filed as part of IAC/InterActiveCorp s consolidated group, expired on

July 1, 2014. As a result, previously unrecognized tax benefits, including interest, totaling $25.6 million were recognized in the third quarter of 2014 in continuing operations.

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The IRS is currently examining Expedia s U.S. consolidated federal income tax returns for the periods ended December 31, 2009 through December 31, 2010.

Note 10 Commitments and Contingencies

Exit Rights

In conjunction with our marketing agreement with Travelocity entered into in 2013, we have agreed to certain put/call rights whereby we may acquire or Sabre may sell to us certain assets relating to the Travelocity business. The put right held by Sabre may be exercised until August 31, 2015 only upon the occurrence of certain triggering events primarily related to the implementation of the solution, which are outside the control of Sabre. The occurrence of such events is not considered probable. After August 31, 2015, the put right is only exercisable for a limited period of time in 2016 and 2017 at a discount to fair market value. The call right held by Expedia is exercisable at any time during the term of the arrangement, the value of which, if exercised, is not expected to exceed fair value.

Legal Proceedings

In the ordinary course of business, we are a party to various lawsuits. Management does not expect these lawsuits to have a material impact on the liquidity, results of operations, or financial condition of Expedia. We also evaluate other potential contingent matters, including value-added tax, federal excise tax, transient occupancy or accommodation tax and similar matters. We do not believe that the aggregate amount of liability that could be reasonably possible with respect to these matters would have a material adverse effect on our financial results; however, litigation is inherently uncertain and the actual losses incurred in the event that our legal proceedings were to result in unfavorable outcomes could have a material adverse effect on our business and financial performance.

Litigation Relating to Hotel Occupancy Taxes. Eighty-eight lawsuits have been filed by cities, counties and states involving hotel occupancy taxes. Thirty-five lawsuits are currently active. These lawsuits are in various stages and we continue to defend against the claims made in them vigorously. With respect to the principal claims in these matters, we believe that the ordinances at issue do not apply to the services we provide, namely the facilitation of hotel reservations, and, therefore, that we do not owe the taxes that are claimed to be owed. We believe that the ordinances at issue generally impose occupancy and other taxes on entities that own, operate or control hotels (or similar businesses) or furnish or provide hotel rooms or similar accommodations. To date, thirty-seven of these lawsuits have been dismissed. Some of these dismissals have been without prejudice and, generally, allow the governmental entity or entities to seek administrative remedies prior to pursuing further litigation. Twenty-three dismissals were based on a finding that we and the other defendants were not subject to the local hotel occupancy tax ordinance or that the local government lacked standing to pursue their claims. As a result of this litigation and other attempts by certain jurisdictions to levy such taxes, we have established a reserve for the potential settlement of issues related to hotel occupancy taxes, consistent with applicable accounting principles and in light of all current facts and circumstances, in the amount of $60 million as of September 30, 2014 and $46 million as of December 31, 2013. It is also reasonably possible that amounts paid in connection with the settlement of these issues could include up to an additional $25 million related to interest payments in one jurisdiction. Our settlement reserve is based on our best estimate of probable losses and the ultimate resolution of these contingencies may be greater or less than the liabilities recorded. Other than as discussed above, an estimate for a reasonably possible loss or range of loss in excess of the amount reserved cannot be made. Changes to the settlement reserve are included within legal reserves, occupancy tax and other in the consolidated statements of operations.

Litigation Relating to Other Taxes. On January 31, 2011, the online travel companies received final notices of assessment from the Hawaii Department of Taxation for general excise taxes for the tax years 2000 to 2011 on their services relating to non-commissioned hotel room reservations. The online travel companies appealed these assessments to the Hawaii tax court. On January 11, 2013, the Hawaii tax court ruled that the online travel companies are obligated to remit past Hawaii general

Notes to Consolidated Financial Statements (Continued)

excise taxes with interest both on the amount paid to the online travel companies for their services and the amount paid to the hotel for the room; thus subjecting the hotel s charge for the room to double taxation because tax amounts on the hotel room had already been paid for all of the years at issue. On March 15, 2013, the Hawaii tax court issued penalties against the online travel companies for their failure to file returns and pay general excise taxes. On August 12, 2013, the court further held that interest is due on such penalties. During the pendency of the tax court proceeding, the online travel companies petitioned the Hawaii Supreme Court for immediate review of the tax court s ruling holding the companies liable for general excise tax. The Hawaii Supreme Court denied the online travel companies petition on April 22, 2013. The tax court proceeding subsequently concluded and on September 11, 2013, the online travel companies filed their notice of appeal. On December 24, 2013, the Hawaii Supreme Court agreed to accept transfer and review of the case. On October 2, 2014, the Hawaii Supreme Court heard oral argument in the appeal. The case is now before the Hawaii Supreme Court for decision.

On May 20, 2013, the Department of Taxation issued final assessments for general excise taxes against the Expedia companies for non-commissioned hotel reservations totaling $20.5 million for the tax year 2012. On June 17, 2013, the online travel companies appealed these assessments to the Hawaii tax court. On December 13, 2013, the tax court held proceedings in abeyance pending review and decision by the Hawaii Supreme Court on the prior assessments.

On December 9, 2013, the Department of Taxation issued final assessments for general excise taxes against the Expedia companies for non-commissioned travel agency services relating to rental cars totaling $29.2 million for the tax years 2000 through 2012. These assessments include a duplicative assessment for Expedia and Hotels.com totaling $9.3 million and thus are overstated. The online travel companies appealed the assessments to the Hawaii tax court. On March 12, 2014, the online travel companies requested that the tax court stay consideration of these assessments pending the decision by the Hawaii Supreme Court relating to the Department of Taxation s claimed right to taxes for non-commissioned travel agency services relating to hotel room reservations. On April 28, 2014, the tax court granted the online travel companies request that the court stay consideration of the Department of Taxation s car rental assessments pending a decision by the Hawaii Supreme Court.

On July 18, 2014, the Department of Taxation issued final general excise tax assessments against the Expedia companies for non-commissioned travel agency services relating to hotel reservations and car rental for the tax year 2013. The Expedia companies have contested these assessments and requested additional information from the Department of Taxation regarding the basis for the amounts assessed.

Pay-to-Play. Certain jurisdictions may assert that we are required to pay any assessed taxes prior to being allowed to contest or litigate the applicability of the ordinances. This prepayment of contested taxes is referred to as pay-to-play. Payment of these amounts is not an admission that we believe we are subject to such taxes and, even when such payments are made, we continue to defend our position vigorously. If we prevail in the litigation, for which a pay-to-play payment was made, the jurisdiction collecting the payment will be required to repay such amounts, plus interest.

San Francisco. During 2009, we paid $48 million in advance of litigation relating to occupancy tax proceedings with the city of San Francisco. The city of San Francisco subsequently issued additional assessments of tax, penalties and interest for the time period from the fourth quarter of 2007 through the fourth quarter of 2011 against the online travel companies, including against Expedia, Hotels.com and Hotwire. The additional assessments, including the prepayment of such assessments, were contested by the Expedia companies on the basis that the court has already ruled that taxes are not due from the online travel companies and that binding precedent by the California Court of Appeals precludes the city s claim for taxes. Although the city initially agreed, subject to documentation, that the additional assessments need not be paid and could be placed under a bond, it subsequently sought to collect the additional assessment against the Expedia companies. On May 14, 2014, the court heard oral argument on the Expedia companies contest of the prepayment requirement for the additional assessments and held that the Expedia companies were required to prepay in order to litigate the legality of the assessments. On May 26, 2014, the Expedia companies paid $25.5 million under protest in order to contest the additional assessments. The additional assessments were expensed during the second quarter of 2014. On August 6, 2014, the California Court of Appeals stayed this case pending review and decision by the California Supreme Court of the *City of San Diego, California Litigation.*

Hawaii. As a pre-condition to appealing the tax court rulings in the Hawaii excise tax proceedings, the Expedia companies were required pay an amount equal to taxes, penalties and interest. During 2012, we expensed $110 million, and

during 2013, we expensed an additional $64 million for amounts required or expected to be paid prior to appealing the tax court s ruling. The total amount that the Expedia companies paid in 2013 was $171 million, which is comprised of $78 million in taxes, $41 million in penalties and $52 million in interest.

The ultimate resolution of these contingencies may be greater or less than the pay-to-play payments made and our estimates of additional assessments mentioned above in Litigation Relating to Other Taxes.

Other Jurisdictions. The city of Portland, Oregon and Multnomah County, Oregon are seeking to require online travel companies to pre-pay hotel occupancy taxes claimed to be due from the fourth quarter 2013 to the present due to a change in law by the Oregon legislature. Hotels.com is currently under audit by the State of Texas, which imposes a pay-to-play requirement to challenge an adverse audit result in court.

Matters Relating to Hotel Booking Practices. On July 31, 2012, the United Kingdom Office of Fair Trading (OFT) issued a Statement of Objections alleging that Expedia, Booking.com B.V. and InterContinental Hotels Group PLC (IHG) have infringed European Union and United Kingdom competition law in relation to the online supply of hotel room accommodations. The parties voluntarily proposed to address the OFT s investigation by offering formal commitments. On January 31, 2014, the OFT announced that it had formally accepted the commitments offered by the parties, with no finding of fault or liability. On April 2, 2014, Skyscanner Limited filed an appeal challenging the OFT s January 31, 2014 decision. On September 26, 2014, the United Kingdom s Competition Appeal Tribunal granted Skyscanner Limited s appeal. This judgment requires the Competition & Markets Authority (CMA), the United Kingdom s competition authority, to review the decision of its predecessor body, the OFT. Expedia continues to believe the commitments it voluntarily gave to the OFT, and which specify certain hotel room discounting rights for online travel companies, represent a sensible and balanced outcome to the OFT s three year investigation. We therefore intend to continue to apply these commitments pending further developments.

In addition, a number of competition authorities in other European countries have initiated investigations into competitive practices within the travel industry and, in particular, in relation to Most Favored Nations clauses and other contractual arrangements between hotels and online travel companies, including Expedia. These investigations differ from the OFT investigation, in relation to the parties involved and the precise nature of the concerns. We are unable at this time to predict the outcome of these investigations and their impact, if any, on our business and results of operations.

Since August 20, 2012, more than thirty putative class action lawsuits, which refer to the OFT s Statement of Objections, have been initiated in the United States by consumer plaintiffs alleging claims against the online travel companies, including Expedia, and several major hotel chains for alleged resale price maintenance for online hotel room reservations, including but not limited to violation of the Sherman Act, state antitrust laws, state consumer protection statutes and common law tort claims, such as unjust enrichment. The cases have been consolidated and transferred to Judge Boyle in the United States District Court for the Northern District of Texas. On February 18, 2014, the court granted defendants motion to dismiss, but allowed the plaintiffs the opportunity to move for leave to amend their complaint. On October 27, 2014, the court denied plaintiffs motion for leave to amend. On October 28, 2014, the court entered judgment in favor of the online travel companies and dismissed the lawsuit.

Note 11 Segment Information

We have two reportable segments: Leisure and Egencia. Our Leisure segment, which consists of the aggregation of operating segments, provides a full range of travel and advertising services to our worldwide customers through a variety of brands including: Expedia.com and Hotels.com in the United States and localized Expedia and Hotels.com websites throughout the world, Expedia Affiliate Network, Hotwire.com, Venere, eLong, trivago and Classic Vacations. Our Egencia segment provides managed travel services to corporate customers in North America, Europe, and the Asia Pacific region.

We determined our operating segments based on how our chief operating decision makers manage our business, make operating decisions and evaluate operating performance. Our primary operating metric is adjusted EBITDA. Adjusted EBITDA for our Leisure and Egencia segments includes allocations of certain expenses, primarily cost of revenue and facilities, and our Leisure segment includes the total costs of our global supply organizations as well as the realized foreign currency gains or losses related to the forward contracts hedging a component of our net merchant hotel revenue. We base the allocations

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primarily on transaction volumes and other usage metrics. We do not allocate certain shared expenses such as accounting, human resources, information technology and legal to our reportable segments. We include these expenses in Corporate. Our allocation methodology is periodically evaluated and may change.

Corporate also includes unallocated corporate functions and expenses. In addition, we record amortization of intangible assets and any related impairment, as well as stock-based compensation expense, restructuring charges, legal reserves, occupancy tax and other, and other items excluded from segment operating performance in Corporate. Such amounts are detailed in our segment reconciliation below.

The following tables present our segment information for the three and nine months ended September 30, 2014 and 2013. As a significant portion of our property and equipment is not allocated to our operating segments and depreciation is not included in our segment measure, we do not report the assets by segment as it would not be meaningful. We do not regularly provide such information to our chief operating decision makers.

	Three months ended September 30, 2014			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	$ 1,615,837	$ 96,667	$	$ 1,712,504
Adjusted EBITDA	$ 494,596	$ 15,773	$ (101,299)	$ 409,070
Depreciation	(35,795)	(4,790)	(26,884)	(67,469)
Amortization of intangible assets			(18,519)	(18,519)
Stock-based compensation			(22,304)	(22,304)
Legal reserves, occupancy tax and other			(3,888)	(3,888)
Realized gain on revenue hedges	(54)			(54)
Operating income (loss)	$ 458,747	$ 10,983	$ (172,894)	296,836
Other expense, net				(7,311)
Income before income taxes				289,525
Provision for income taxes				(38,904)
Net income				250,621
Net loss attributable to noncontrolling interests				6,438
Net income attributable to Expedia, Inc.				$ 257,059

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	Three months ended September 30, 2013			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	$ 1,316,483	$ 85,377	$	$ 1,401,860
Adjusted EBITDA	$ 419,156	$ 11,482	$ (90,741)	$ 339,897
Depreciation	(26,525)	(3,643)	(22,797)	(52,965)
Amortization of intangible assets			(18,514)	(18,514)
Stock-based compensation			(18,039)	(18,039)
Legal reserves, occupancy tax and other			(6,874)	(6,874)
Realized gain on revenue hedges	(4,814)			(4,814)
Operating income (loss)	$ 387,817	$ 7,839	$ (156,965)	238,691
Other expense, net				(26,611)
Income before income taxes				212,080
Provision for income taxes				(45,356)
Net income				166,724
Net loss attributable to noncontrolling interests				4,135
Net income attributable to Expedia, Inc.				$ 170,859

	Nine months ended September 30, 2014			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	$ 4,107,488	$ 300,019	$	$ 4,407,507
Adjusted EBITDA	$ 1,017,876	$ 49,435	$ (292,214)	$ 775,097
Depreciation	(99,247)	(13,946)	(81,968)	(195,161)
Amortization of intangible assets			(55,275)	(55,275)
Stock-based compensation			(68,139)	(68,139)
Legal reserves, occupancy tax and other			(38,843)	(38,843)
Realized loss on revenue hedges	5,379			5,379
Operating income (loss)	$ 924,008	$ 35,489	$ (536,439)	423,058
Other expense, net				(46,413)
Income before income taxes				376,645
Provision for income taxes				(59,974)