

Expedia, Inc.
Form 10-K
February 28, 2007

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006**

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

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

20-2705720

*(I.R.S. Employer
Identification No.)*

**3150 139th Avenue SE
Bellevue, WA 98005**

(Address of principal executive office) (Zip Code)

**Registrant's telephone number, including area code:
(425) 679-7200**

Securities registered pursuant to Section 12(b) of the Act:

Common stock, \$0.001 par value

Warrants to acquire one-half of one share of common stock, \$0.001 par value

Warrants to acquire 0.969375 shares of common stock, \$0.001 par value

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of June 30, 2006, the aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates was \$4,087,526,000. For the purpose of the foregoing calculation only, all directors and executive officers of the registrant are assumed to be affiliates of the registrant.

Class	Outstanding Shares at February 15, 2007 were approximately,
Common stock, \$0.001 par value per share	276,640,572 shares
Class B common stock, \$0.001 par value per share	25,599,998 shares

Documents Incorporated by Reference

Document	Parts Into Which Incorporated
Proxy Statement for the 2007 Annual Meeting of Stockholders (Proxy Statement)	Part III

Expedia, Inc.

**Form 10-K
For the Year Ended December 31, 2006**

Contents

Part I

<u>Item 1</u>	<u>Business</u>	2
<u>Item 1A</u>	<u>Risk Factors</u>	11
<u>Item 1B</u>	<u>Unresolved Staff Comments</u>	18
<u>Item 2</u>	<u>Properties</u>	18
<u>Item 3</u>	<u>Legal Proceedings</u>	18
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	27

Part II

<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	27
<u>Item 6</u>	<u>Selected Financial Data</u>	28
<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 8</u>	<u>Consolidated Financial Statements and Supplementary Data</u>	47
<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	47
<u>Item 9A</u>	<u>Controls and Procedures</u>	47
<u>Item 9B</u>	<u>Other Information</u>	50

Part III

<u>Item 10</u>	<u>Directors and Executive Officers of the Registrant</u>	50
<u>Item 11</u>	<u>Executive Compensation</u>	50
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	50
<u>Item 13</u>	<u>Certain Relationships and Related Transactions</u>	50
<u>Item 14</u>	<u>Principal Accountant Fees and Services</u>	50

Part IV

<u>Item 15</u>	<u>Exhibits, Consolidated Financial Statements and Financial Statement Schedules</u>	50
<u>Signatures</u>		53
<u>EXHIBIT 21.1</u>		
<u>EXHIBIT 23.1</u>		
<u>EXHIBIT 23.2</u>		
<u>EXHIBIT 31.1</u>		
<u>EXHIBIT 31.2</u>		
<u>EXHIBIT 31.3</u>		
<u>EXHIBIT 32.1</u>		
<u>EXHIBIT 32.2</u>		
<u>EXHIBIT 32.3</u>		

Table of Contents

Expedia, Inc.

Form 10-K

For the Year Ended December 31, 2006

Part I. Item 1. *Business*

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the views of our management regarding current expectations and projections about future events and are based on currently available information. Actual results could differ materially from those contained in these forward-looking statements for a variety of reasons, including, but not limited to, those discussed in the section entitled Risk Factors as well as those discussed elsewhere in this report. Other unknown or unpredictable factors also could have a material adverse effect on our business, financial condition and results of operations. Accordingly, readers should not place undue reliance on these forward-looking statements. The use of words such as anticipates, estimates, expects, intends, plans and believe among others, generally identify forward-looking statements; however, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. These forward-looking statements are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. We are not under any obligation and do not intend to publicly update or review any of these forward-looking statements, whether as a result of new information, future events or otherwise, even if experience or future events make it clear that any expected results expressed or implied by those forward-looking statements will not be realized. Please carefully review and consider the various disclosures made in this report and in our other reports filed with the Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

Management Overview

General Description of our Business

Expedia, Inc. is an online travel company, empowering business and leisure travelers with the tools and information they need to efficiently research, plan, book and experience travel. We have created a global travel marketplace used by a broad range of leisure and corporate travelers and offline retail travel agents as well as travel service providers. We make available, on a stand-alone and package basis, travel products and services provided by numerous airlines, lodging properties, car rental companies, destination service providers, cruise lines and other travel product and service companies.

Our portfolio of brands, which is described below, includes: Expedia.com[®], Hotels.com[®], Hotwire.com[™], Worldwide Travel Exchange (WWTE) and Interactive Affiliate Network (IAN), Classic Vacations, Expedia Corporate Travel (ECT), eLong and TripAdvisor[®]. 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 this Annual Report on Form 10-K.

Summary of the Spin-Off from IAC/InterActiveCorp

On December 21, 2004, IAC/InterActiveCorp (IAC) announced its plan to separate into two independent public companies to allow each company to focus on its individual strategic objectives. We refer to this transaction as the

Spin-Off. A new company, Expedia, Inc., was incorporated under Delaware law in April 2005, to hold substantially all of IAC's travel and travel-related businesses.

On August 9, 2005, the Spin-Off was completed and Expedia, Inc. shares began trading on The Nasdaq Stock Market, Inc. (NASDAQ) under the symbol EXPE. In conjunction with the Spin-Off, we completed the following transactions:

- (1) transferred to IAC all cash in excess of \$100 million, excluding the cash and cash equivalents held by eLong;
- (2) extinguished all intercompany receivable balances from IAC, which

Table of Contents

totaled \$2.5 billion, by recording a non-cash distribution to IAC; (3) recorded a non-cash contribution from IAC of a joint ownership interest in an airplane, with a value of \$17.4 million; (4) recorded a non-cash contribution of media time, with a value of \$17.1 million; (5) recorded derivative liabilities for the stock warrants and Ask Jeeves Convertible Subordinated Notes (Ask Jeeves Notes) with a fair value of \$101.6 million; (6) recorded a modification of stock-based compensation awards of \$5.4 million; and (7) recapitalized the invested equity balance with common stock, Class B common stock and preferred stock, whereby holders of IAC stock received shares of Expedia stock based on a formula.

Equity Ownership and Voting Control

As of December 31, 2006, there were approximately 305,901,048 shares of Expedia common stock, 25,599,998 shares of Expedia Class B common stock and 846 shares of Expedia preferred stock outstanding. Liberty Media Corporation (Liberty), through companies owned by Liberty and companies owned jointly by Liberty and Barry Diller, Chairman and Senior Executive of Expedia, beneficially owned approximately 19% of Expedia's outstanding common stock and 100% of Expedia's outstanding Class B common stock. As of such date, Mr. Diller (through his own holdings and holdings of Liberty, over which Mr. Diller generally has voting control pursuant to an irrevocable proxy granted by Liberty under the Stockholders Agreement described below) controlled approximately 55% of the outstanding total voting power of Expedia. Following our repurchase of 30 million shares of our common stock on January 19, 2007, Mr. Diller controlled approximately 58% of the outstanding voting power of Expedia.

Pursuant to the Stockholders Agreement, dated as of August 9, 2005, between Liberty and Mr. Diller, Mr. Diller is effectively able to control the outcome of nearly all matters submitted to a vote or for the consent of Expedia's stockholders (other than with respect to the election by the Expedia common stockholders of 25% of the members of Expedia's Board of Directors and certain matters as to which a separate class vote of the holders of Expedia common stock or Expedia preferred stock is required under Delaware law). In addition, pursuant to the Governance Agreement, dated as of August 9, 2005, among Expedia, Liberty and Mr. Diller, each of Mr. Diller and Liberty generally has the right to consent to certain significant corporate actions in the event that Expedia's ratio of total debt to EBITDA, as defined therein, equals or exceeds four to one over a continuous 12-month period.

Portfolio of Brands

Expedia leverages its brand portfolio to target the broadest possible range of travel suppliers and travelers looking for travel options. Our brands provide a wide selection of travel products and services, from simple, discounted travel to more complex, luxury travel. Our products primarily consist of airline flights, hotel stays, car rentals, destination services and cruises.

Expedia[®]. Our Expedia-branded websites make a large variety of travel products and services available directly to travelers through our U.S.-based website, www.expedia.com, as well as through localized versions of our website in Australia, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden and the United Kingdom. Expedia-branded websites also serve as the travel channel on MSN.com, Microsoft Corporation's (Microsoft) online services network in the United States, as well as certain international MSN sites. Expedia-branded websites target many different types of travelers, from families booking a summer vacation to individual travelers arranging a quick weekend getaway. Travelers can search for, compare information about (including pricing and availability) and book travel products and services on Expedia-branded websites, including airline tickets, lodging, car rentals, cruises and many destination services such as attractions and tours from a large number of suppliers, on both a stand-alone and package basis.

Hotels.com[®]. Our Hotels.com website makes available a large variety of lodging options to travelers, who can plan, shop for and book lodging accommodations, from traditional hotels to vacation rentals. Hotels.com seeks to provide

travelers with premium content and service through our U.S.-based website, www.hotels.com, as well as through localized versions in the Americas, Europe, Asia Pacific and South Africa.

Table of Contents

With Hotels.com, we differentiate our offering by positioning the brand as a hotel expert with premium content about lodging properties.

*Hotwire.com*tm. Our discount travel website, Hotwire.com, makes available airline tickets, hotel rooms, rental cars, cruises and vacation packages. Hotwire.com's approach matches flexible, price-sensitive travelers with suppliers who have excess seats, rooms and cars they wish to fill without affecting the public's perception of their brands. Hotwire.com travelers may enjoy significant discounts by electing to book travel services opaquely or semi-opaquely, without knowing certain itinerary details such as brand, time of departure and exact hotel location, while suppliers create value from excess inventory without diluting their core brand-loyal traveler base. Hotwire.com works with many domestic and international airlines, including U.S. full-service major network airlines, top hotels in hundreds of cities and resort destinations in the United States, Europe, Canada, Mexico and the Caribbean and major car rental companies in the United States.

Worldwide Travel Exchange and Interactive Affiliate Network. Our private label programs make travel products and services available to travelers through third-party company-branded websites. The products and services made available through our websites, www.wwte.com and www.ian.com, are substantially similar to those made available on Expedia-branded and Hotels.com-branded websites, respectively. We generally compensate participants in the WWTE[®] and IANtm private label programs on a revenue-share basis.

Classic Vacations[®]. We offer individually tailored vacations that we provide primarily through a national network of third-party retail travel agents. We deliver a full line of premium vacation packages—air, hotels, car rentals, activities and private transportation—to create customized luxury vacations in Hawaii, the Caribbean, Mexico, Costa Rica, Europe, Australia, New Zealand and Tahiti. Travel agents and travelers can preview our product offering through our websites, www.classicforagents.com and www.classicvacations.com.

Destination Services. Our network of travel desks located at hotels and resorts in Florida, Hawaii, and Mexico makes available to travelers the opportunity to obtain tours, attractions, airport transfer services and other travel-related services. Our network expanded through our acquisition of Activity World and Activity Hut, destination service providers in Hawaii in 2004 and 2006, and our 2005 acquisition of Premier Getaways in Florida.

Expedia[®] *Corporate Travel*. Our full-service travel management company makes travel products and services available to corporate travelers in the United States, Canada and Europe. In 2004, we established ECT—Europe, which includes Egencia and World Travel Management, both of which were acquired in 2004. ECT provides, among other things, centralized booking tools for employees of our corporate travelers, support of negotiated airfares and consolidated reporting aimed at small- and mid-sized businesses. ECT charges corporate client companies account management fees, as well as transactional fees for making or changing bookings. In addition, ECT provides on-site agents to some corporate clients in order to more fully support the account.

*eLong*tm. Our majority owned online travel service company, based in Beijing, the People's Republic of China (China), specializes in travel products and services in China. eLong uses web-based distribution technologies and a 24-hour nationwide call center to provide consumers with consolidated travel information and the ability to access hotel reservations at discounted rates at over 3,500 hotels in major cities across China. eLong also offers air ticketing and other travel related services, such as rental cars and vacation packages. Travelers can access travel products and services through the websites, www.elong.com and www.elong.net.

TripAdvisor[®]. Our comprehensive online travel search engine and directory aggregates unbiased articles, guidebook reviews and user opinions on cities, hotels and activities in a variety of destinations from a number of online sources through our websites, www.tripadvisor.com and www.tripadvisor.co.uk. In addition to travel-related information, TripAdvisor's destination-specific search results provide links to the websites of TripAdvisor's travel partners (travel

service providers and marketers) through which travelers can make related travel arrangements.

Table of Contents

Business Strategy

Expedia, Inc. is building the world's largest and most intelligent travel marketplace. We play a fundamental role in facilitating travel, whether for leisure or business. We are committed to providing our travelers with the best set of resources to serve their travel needs by taking advantage of our critical assets—our brand portfolio, our technologies and continuous innovation, our global reach, and our breadth of product offering. In doing so, we take advantage of our growing base of knowledge about our destinations, suppliers and travelers based on our unique position in the travel value chain.

A discussion of the critical assets that we leverage in achieving our business strategy follows:

Portfolio of Travel Brands. We seek to appeal to the broadest possible range of travelers and suppliers through our collection of industry-leading brands. We target several different demographics, from the value-conscious traveler through our Hotwire brand to luxury travelers seeking a high-touch, customized vacation package through our Classic Vacations brand. We believe our flagship Expedia brand appeals to the broadest range of travelers, with our extensive product offering and facilitation of single item bookings of discounted product to complex bundling of higher-end travel packages. Our Hotels.com site and its international versions target travelers with premium content about lodging properties, and generally appeal to travelers with shorter booking windows who prefer to drive to their destinations.

We believe our appeal to suppliers is enhanced by our brand portfolio and our international points of sale, by allowing suppliers to access the broadest possible range of travelers with their product and service offerings. We intend to continue supporting and investing in our brand portfolio for the benefit of travelers and suppliers.

Technologies and Continuous Innovation. Expedia has an established tradition of innovation, from Expedia.com's inception as a division of Microsoft, to our introduction of more recent innovations such as our ThankYou Rewards Network offered in conjunction with Citigroup, Expedia® Fare Alerts, Travel Ticker™ by Hotwire®, TripAdvisor's wikis and ECT's business intelligence toolset.

We intend to continue to aggressively innovate on behalf of our travelers, including our current efforts in building a scaleable, extensible, service-oriented technology platform, which will extend across our portfolio of brands. We expect this to result in improved flexibility and faster go-forward innovation. This transition should allow us to improve our site merchandising, browse and search functionality and add significant personalization features. We expect this transition to occur in a phased approach, with portions of our worldwide points of sale migrating to the new platform beginning in 2007.

We also intend to continue innovating on behalf of our suppliers. As an example, we have developed proprietary, supplier-oriented technology that streamlines the interaction between some of our websites and hotel central reservation systems, making it easier and more cost-effective for hotels to manage reservations made through our brands. Through this direct connect technology, hotels can upload information about available products and services and rates directly from their central reservation systems into our websites, as well as automatically confirm hotel reservations made by our travelers. In the absence of direct connect technology, both of these processes are generally completed manually via a proprietary extranet. Our travelers can book reservations with over 30,000 worldwide merchant hotel properties, of which over 35% are now fully direct-connected. We are planning to offer more streamlined application programming interfaces for our lodging partners in 2007, to enable faster and simpler integration of real-time hotel content.

We are also improving our data handling capabilities across Expedia with the installation of an enterprise data warehouse, which will allow enhanced personalization on both our websites and e-mail communications with our travelers. The project is scheduled to begin yielding benefits to our travelers beginning in 2007.

Global Reach. In 2006, our international gross bookings accounted for approximately 26% of worldwide gross bookings and 28% of revenue. We currently operate over 50 branded points of sale across the globe, including Expedia-branded sites in the United States, Australia, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden and the United Kingdom. Our Hotels.com and TripAdvisor brands

Table of Contents

also maintain both U.S. points of sale and additional points of sale outside the United States. Lastly, we offer Chinese travelers a wide array of products and services through our majority ownership in eLong.

We intend to continue investing in and growing our existing international points of sale, including the expected launch of an Expedia-branded site in India in 2007. We anticipate launching points of sale in additional countries where we find large travel markets and rapid growth of online commerce. Future launches, such as India, may occur under our flagship Expedia brand, through one of our other brands, or through acquisition of third-party brands, as in the case of eLong.

ECT currently conducts operations in the United States, Belgium, Canada, France, Germany and the United Kingdom. We believe the corporate travel sector represents a large opportunity for Expedia, and we believe we offer a compelling technology solution to small and medium-sized businesses seeking to control travel costs and improve their employees' travel experiences. We also believe that expanding our corporate travel business also increases our appeal to travel product and service suppliers, as the average corporate traveler has a higher incidence of first class and international travel than the average leisure traveler. We intend to continue investing in and expanding the geographic footprint of our ECT business.

In expanding our global reach, we are leveraging our significant investment in technology, operations, brand building, supplier integration and relationships and other areas since the launch of Expedia.com in 1996.

We intend to continue leveraging this investment when launching new countries, introducing website features, adding supplier products and services or adding value-added content for travelers. As a result, we have been able to launch several websites including Expedia-branded sites in Japan, Denmark, Norway and Sweden relatively quickly and cost effectively.

Our scale of operations also enhances the value of technology innovations we introduce on behalf of our travelers and suppliers. As an example, our traveler review feature whereby Expedia travelers have created over 300,000 qualified reviews of hotel properties is able to accumulate a larger base of reviews due to the higher base of online traffic that frequents our various websites.

Breadth of Product Offering. In general, through our websites, we believe we offer a comprehensive array of innovative travel products and services to travelers. We plan to continue improving and growing these offerings, as well as expand them to our worldwide points of sale over time.

The majority of our revenue comes from transactions involving the sale of airline tickets and the booking of hotel reservations, either as stand-alone products or as part of package transactions. We are working to grow our package business as it results in higher revenue per transaction, and we also seek to continue diversifying our revenue mix beyond core air and hotel products to car rental, destination services, cruise and other product offerings, as well as by increasing the mix of revenue from advertising we derive from our travel partners and suppliers.

Merchant and Agency Business Models

We make travel products and services available both on a stand-alone and package basis, primarily through two business models: the merchant model and the agency model. Under the merchant model, we facilitate the booking of hotel rooms, airline seats, car rentals and destination services from our travel suppliers and for such bookings, we are the merchant of record. Under the agency model, we act as an agent in the transaction, passing reservations booked by our travelers to the relevant airline, hotel, car rental company or cruise line.

As merchant of record, we generally have certain latitude to establish prices charged to travelers (as compared to agency transactions). Also, we negotiate inventory allocation and pricing with our suppliers which enables us to achieve a higher level of net revenue per transaction as compared to those provided through the agency model.

Through our Expedia-branded websites, travelers can dynamically assemble multiple component travel packages in a single transaction at a lower price as compared to booking each component separately. Packages assembled by travelers through the packaging model on these websites include a merchant hotel component

Table of Contents

and an air or car component. Travelers select packages based on the total package price, without being provided component pricing. The use of the merchant travel components in packages enables us to make certain travel products available at prices lower than those charged on an individual component basis by travel suppliers without impacting their established pricing and position models. We are also expanding our use of third-party provided pre-assembled package offerings, particularly through our international points of sale, further broadening our scope of products and services to travelers.

Our agency business is comprised of the sale of airline tickets, hotel, cruise and car rental reservations. Airline ticket transactions make up the majority of this business. Although net revenue per transaction is lower (as compared to the merchant model), due to the high volume of airline tickets sold, our agency gross bookings accounted for 59% of total gross bookings for the year ended December 31, 2006.

Relationships with Travel Suppliers, Distribution and Fulfillment Partners

Overview. We make travel products and services available from a variety of large and small commercial and charter airlines, lodging properties, car rental companies, cruise lines and destination service providers. We seek to build and maintain long-term, strategic relationships with travel suppliers and global distribution system (GDS) partners. An important component of the success of our business depends on our ability to maintain our existing, as well as build new, relationships with travel suppliers and GDS partners.

Travel Suppliers. We strive to deliver value to our travel suppliers through a wide range of innovative, targeted merchandising and promotional strategies designed to increase their revenue, while simultaneously reducing their marketing transaction and customer service costs. Our Partner Services Group consists mainly of strategic account managers and local market managers who work directly with travel suppliers to increase the marketing of their travel products and brands through our points of sale.

In addition, we have developed proprietary, supplier-oriented technology that streamlines the interaction between some of our websites and hotel central reservation systems, making it easier and more cost-effective for hotels to manage reservations made through our brands. Through this direct connect technology, hotels can upload information about available products and services and rates directly from their central reservation systems into our websites, as well as automatically confirm hotel reservations made by our travelers. In the absence of direct connect technology, both of these processes are generally completed manually via a proprietary extranet. Our travelers can book reservations with over 30,000 merchant hotel properties worldwide, of which over 35% are now fully direct-connected.

Distribution Partners. GDSs, also referred to as computer reservation services, provide a centralized, comprehensive repository of travel suppliers content such as availability and pricing of seats on various airline point-to-point flights, or segments. The GDSs act as intermediaries between the travel suppliers and online and offline travel agencies, allowing agents to reserve and book flights, rooms or other travel products.

While we have historically used Worldspan as our primary GDS, in light of the deregulated GDS environment and our desire to ensure the widest possible supply of air content for our travelers, in 2006 we diversified our use of GDS providers through distribution agreements, and now use Worldspan, Amadeus and Sabre.

Fulfillment Partners. We outsource certain of our airline ticket fulfillment functions to third-party suppliers. Such functions include the issuance of airline tickets and related customer services.

Marketing and Promotions

Our marketing programs are intended to build and maintain the value of our various brands, drive traffic and conversion through our various brands and businesses, lower ongoing traveler acquisition costs and strategically position our brands in relation to one another. Our long-term success depends on our continued ability to increase the overall number of traveler transactions in a cost-effective manner.

Our marketing channels primarily include direct and/or personalized traveler communications on our websites and through e-mail communications, search engine marketing and optimization as well as online and

Table of Contents

offline advertising. In addition, our Expedia-branded websites provide content and services to the travel channel on the MSN.com website in the United States and MSN websites in Canada, France, Germany, Italy, and the United Kingdom. Our marketing programs and initiatives include promotional offers such as coupons and gift cards. In addition, we introduced the ThankYou Rewards Network during the fourth quarter of 2006, whereby travelers earn points for their travel bookings.

We also make use of affiliate marketing. The Expedia.com and Hotels.com-branded websites receive bookings from consumers who have clicked-through to the respective websites through links posted on affiliate partner websites. We have agreements with thousands of third-party affiliate partners, including a number of leading travel companies, pursuant to which we pay a commission for bookings originated from their websites. Affiliate partners can make travel products and services available through an Expedia-branded website, a co-branded website or their own private label website. We also provide our affiliates with technology and access to a wide range of products and services.

Operations and Technology

We provide 24-hour-a-day, seven-day-a-week traveler support by telephone or via e-mail. For purposes of operational flexibility, we provide this support infrastructure with a combination of in-house and outsourced call centers which are located in various locations throughout the world.

Our systems infrastructure and web and database servers are hosted by third-party web hosting suppliers in various locations, mainly in the United States, which provide communication links, as well as 24-hour monitoring and engineering support. The web hosting facilities have their own generators and multiple back-up systems. Significant amounts of our computer hardware for operating the websites are also located at these facilities.

We have developed innovative technology to power our global travel marketplace. For example, our Expert Searching and Pricing Platform (ESP Platform), which our Expedia-branded websites use, includes two components: (1) a fare-searching engine that enables broad and deep airline fare and schedule searches and (2) a common database platform that allows our Expedia-branded websites and our travelers to bundle diverse types of travel services together dynamically, which further enables our Expedia-branded websites to cross-market and package travel inventory. The ESP Platform has been historically an important contributor to our growth in the online travel industry.

Another core piece of our technology suite is our Best Fare Search technology. This technology essentially deconstructs the segment feeds from GDS partners for air flight searches and recommends the best way to re-assemble multi-leg itineraries so that they are less expensive and more flexible for the traveler.

We are investing in and building a scaleable, extensible, service-oriented technology platform which will extend across our portfolio of brands. We plan to significantly invest in this platform in 2007 and 2008. We expect this investment to result in long-term cost savings, improved flexibility and faster go-forward innovation. This transition should also allow us to improve our site merchandising, browse and search functionality, add significant personalization features, and ultimately improve our ability to drive higher return-on-investment in our online and offline advertising. We expect this transition to occur in a phased approach, with portions of our worldwide points of sale migrating to the new platform beginning in 2007.

We are also adding a significant upgrade to our data aggregation and mining capabilities across Expedia with the installation of an enterprise data warehouse, which is scheduled to begin yielding traveler-facing benefits in 2007.

Competition

Our brands compete in rapidly evolving and intensely competitive markets. We believe the relatively low percentage of total travel sales transacted online in the global travel industry indicates that these markets represent especially large opportunities for Expedia and those of its competitors that wish to expand their brands and businesses abroad.

Table of Contents

Our competition, which is strong and increasing, includes online and offline travel companies that target leisure and corporate travelers including travel agencies, tour operators, travel supplier direct websites and their call centers, consolidators and wholesalers of travel products and services and other companies offering travel search engines including meta-search engines. We face these competitors in local, regional, national and/or international markets.

We believe that maintaining and enhancing our brands is a critical component of our effort to compete. We differentiate our brands from our competitors primarily based on quality and breadth of travel products, channel features and usability, price, traveler service and quality of travel planning content and advice. The emphasis on one or more of these factors varies, depending on the brand or business and the related target demographic.

Our brands face increasing competition from travel supplier direct websites. In some cases, supplier direct channels offer advantages to travelers, such as loyalty programs or lower transaction fees. Our websites feature travel products and services from numerous travel suppliers (as opposed to a single supplier), and allow travelers to combine products and services from multiple providers in one transaction. We face competition from airlines, hotels, rental car companies, cruise operators and other travel service providers, whether working individually or collectively, some of which are suppliers to our websites. Our business is generally sensitive to changes in the competitive landscape, including the emergence of new competitors.

Intellectual Property Rights

We regard our intellectual property rights, including our patents, service marks, trademarks, domain names, copyrights, trade secrets and other intellectual property, as critical to our success. For example, we rely heavily upon the software code, informational databases and other components that make up our travel planning service.

We rely on a combination of laws, business practices and contractual obligations with employees, suppliers, affiliates and others to establish and protect our trade secrets. Despite these precautions, it may be possible for a third-party to copy or otherwise obtain and use our trade secrets or our intellectual property without authorization which, if discovered, might require the uncertainty of legal action to correct. In addition, there can be no assurance that others will not independently and lawfully develop substantially similar properties.

We maintain our trademark portfolio by filing trademark applications with the appropriate international trademark offices, maintaining our current registrations, securing contractual trademark rights when appropriate, and relying on common law trademark rights when appropriate. We also register domain names as we deem appropriate. We protect our trademarks and domain names with an enforcement program and use of trademark licenses. While we seek to protect our trademarks and domain names, effective trademark and domain name protection may not be available or may not be sought by us for every trademark and domain name used in every country, and contractual disputes may affect the use of trademarks and domain names governed by private contract. In addition, our infringement monitoring resources may not locate every trademark or domain name infringement that exists. Similarly, not every variation of a domain name may be available, or may be registered by us, even if available. The failure to protect our intellectual property in a meaningful manner, or challenges to our intellectual property rights, could materially adversely affect our business, result in erosion of our brand names and/or limit our ability to control marketing on or through the internet using our various domain names.

We have considered, and will continue to consider, the appropriateness of filing for patents to protect future inventions, as circumstances may warrant. However, many patents protect only specific inventions and there can be no assurance that others may not create new products or methods that achieve similar results without infringing upon patents owned by us.

From time to time, we may be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement by us of the trademarks, copyrights, patents and other intellectual property rights of third-parties. In addition, litigation may be necessary in the future to enforce our

Table of Contents

intellectual property rights, protect our trade secrets or to determine the validity and scope of proprietary rights claimed by others. Any such litigation, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could materially harm our business.

Regulation

We must comply with laws and regulations relating to the travel industry and the provision of travel services, including registration in various states as sellers of travel and compliance with certain disclosure requirements and participation in state restitution funds. In addition, our businesses are subject to regulation by the U.S. Department of Transportation and must comply with various rules and regulations governing the provision of air transportation, including those relating to advertising and accessibility.

As we continue to expand the reach of our brands into the European, Asia-Pacific and other international markets, we are increasingly subject to laws and regulations applicable to travel agents in those markets, including, in some countries, laws regulating the provision of travel packages and industry specific value-added tax regimes. For example, the European Economic Community Council Directive on Package Travel Package Holidays and Package Tours imposes various obligations upon marketers of travel packages, such as disclosure obligations to consumers and liability to consumers for improper performance of the package, including supplier failure.

Financial Information about Segments and Geographic Areas

We generate our revenue through a diverse customer base, and there is no reliance on a single customer or small group of customers; no customer represented 10% or more of our total revenue in the periods presented in this Annual Report on Form 10-K.

In the first quarter of 2006, we began reporting two segments: North America and Europe. The change from a single reportable segment is a result of the reorganization of our business. We have not reported segment information for the years ended December 31, 2005 and 2004, as it is not practicable to do so. Beginning in the first quarter of 2007, we will disclose comparable financial information. The segment and geographic information required herein is contained in Note 16 Segment Information, in the notes to our consolidated financial statements.

Additional Information

Company Website and Public Filings. We maintain a corporate website at www.expediainc.com. Except as explicitly noted, the information on our website, as well as the websites of our various brands and businesses, is not incorporated by reference in this Annual Report on Form 10-K, or in any other filings with, or in any information furnished or submitted to, the SEC.

We make available, free of charge through our website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed or furnished pursuant to Sections 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after they have been electronically filed with, or furnished to, the SEC.

Code of Ethics. We post our code of business conduct and ethics, which applies to all employees, including all executive officers, senior financial officers and directors, on our corporate website at www.expediainc.com. Our code of business conduct and ethics complies with Item 406 of SEC Regulation S-K and the rules of the NASDAQ. We intend to disclose any changes to the code that affect the provisions required by Item 406 of Regulation S-K, and any waivers of the code of ethics for our executive officers, senior financial officers or directors, on our corporate website.

Employees

As of December 31, 2006, we employed approximately 6,600 full-time and part-time employees, including approximately 1,650 employees of eLong. We believe we have good relationships with our

Table of Contents

employees, including relationships with employees represented by works councils or other similar organizations.

Part I. Item 1A. Risk Factors

You should carefully consider each of the following risks and uncertainties associated with our company and the ownership of our securities. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

We operate in an increasingly competitive environment.

The market for the services we offer is increasingly and intensely competitive. We compete with both established and emerging online and traditional sellers of travel services with respect to each of the services we offer. Some of our competitors, particularly travel suppliers such as airlines and hotels, may offer products and services on more favorable terms such as no fees and with unique access to proprietary loyalty programs, such as points and miles. Many of these competitors, such as airlines, hotel and rental car companies, have been steadily focusing on increasing online demand on their own websites in lieu of third-party distributors like us. For instance, many low cost airlines, which are having increasing success in the marketplace, distribute their online inventory exclusively through their own websites. Suppliers who sell on their own websites typically do not charge a processing fee, and, in some instances, offer advantages such as their own bonus miles or loyalty points, which could make their offerings more attractive to consumers than offerings like ours. The introduction of new technologies and the expansion of existing technologies, such as metasearch and other search engine technologies, may increase competitive pressures. Increased competition may result in reduced margins, as well as loss of travelers, transactions and brand recognition. We cannot assure you that we will be able to compete successfully against current, emerging and future competitors or provide differentiated products and services to our traveler base. This competition may result in reduced margins, loss of segment share and damage to our brand.

Over the last several years, we have experienced downward pressure on commissions and payments to us from our suppliers.

A portion of our revenue is derived from compensation paid by travel suppliers and GDS partners for bookings made through our websites. We generally negotiate these commissions and fees with our travel suppliers and GDS partners. Over the last several years, travel suppliers have generally reduced or eliminated commissions and payments to travel agents and other travel intermediaries. In particular, in 2006, GDS partners faced the renegotiation of long-term contracts with airlines on terms that generally resulted in decreased compensation to them. We also renegotiated several long-term contracts with airlines and GDSs with reduced economic benefits. We are currently negotiating and expect to renegotiate other long-term airline and hotel contracts in 2007. No assurances can be given that GDS partners or travel suppliers will not further reduce current industry compensation or our compensation, either of which could reduce our revenue and margins thereby adversely affecting our business and financial performance.

Declines or disruptions in the travel industry could adversely affect our business or financial performance.

Our business and financial performance are affected by the health of the worldwide travel industry. Accordingly, downturns or weaknesses in the travel industry could adversely affect our business. Travel expenditures are sensitive to business and personal discretionary spending levels and tend to decline during general economic downturns. Events or weakness in the travel industry that could negatively affect our business include price escalation in the airline industry or other travel-related industries, airline or other travel-related strikes, airline bankruptcies, liquidations or consolidations and fuel price escalation. Additionally, our business is sensitive to safety concerns, and thus our business may decline after incidents of actual or threatened terrorism, during periods of political instability or geopolitical conflict in which travelers become concerned about safety issues, as a result of inclement weather such as

hurricanes or when travel might involve health-related risks, such as avian flu. Such concerns could result in a protracted decrease in

Table of Contents

demand for our travel services. This decrease in demand, depending on its scope and duration, together with any future issues affecting travel safety, could significantly and adversely affect our business and financial performance over the short and long-term. In addition, the disruption of the existing travel plans of a significant number of travelers upon the occurrence of certain events, such as actual or threatened terrorist activity or war, could result in the incurrence of significant additional costs if we provide relief to affected travelers by not charging cancellation fees and/or by refunding the price of airline tickets, hotel reservations and other travel products and services.

Our business depends on our relationships with travel suppliers.

An important component of our business success depends on our ability to maintain our existing relationships and to build new relationships with travel suppliers and GDS partners. Adverse changes in existing relationships, or our inability to enter into new arrangements with these parties on favorable terms, if at all, could reduce the amount, quality and breadth of attractively priced travel products and services that we are able to offer, which could adversely affect our business and financial performance.

Travel suppliers are increasingly seeking to lower their travel distribution costs by promoting direct online bookings through their own websites. In some cases, supplier direct channels offer advantages to consumers, such as loyalty programs and/or lower transaction fees. In addition, travel suppliers may choose not to make their travel products and services available through our distribution channels. To the extent that consumers continue to increase the percentage of their travel purchases through supplier direct websites and/or if travel suppliers choose not to make their products and services available to us, our business may suffer.

We rely on the performance of highly skilled personnel and, if we are unable to retain or motivate key personnel or hire, retain and motivate qualified personnel, our business would be harmed.

Our performance is largely dependent on the talents and efforts of highly skilled individuals. Our future success depends on our continuing ability to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization. In particular, the contributions of Barry Diller, our Chairman and Senior Executive, and Dara Khosrowshahi, our Chief Executive Officer, are critical to the overall management of the company.

In addition, we have experienced a high rate of executive turnover during the last two years. Our future success will depend on the performance of our senior management and key employees, many of whom joined Expedia recently. Expedia cannot ensure that it will be able to retain the services of Mr. Diller, Mr. Khosrowshahi or any other member of our senior management or key employees, the loss of whom could seriously harm our business. In addition, competition for well-qualified employees in all aspects of our business, including software engineers and other technology professionals, is intense. Our continued ability to compete effectively depends on our ability to attract new employees and to retain and motivate our existing employees. If we do not succeed in attracting well-qualified employees or retaining or motivating existing employees, our business would be adversely affected. We do not maintain any key person life insurance policies.

System interruption and the lack of integration and redundancy in our information systems may harm our businesses.

We rely on our own and third-party computer systems and service providers to facilitate and process a portion of our transactions. We have experienced and may in the future experience system interruptions that make some or all of these systems unavailable or prevent us from efficiently fulfilling orders or providing services to third-parties. Any interruptions, outages or delays in our systems or third-party providers' systems, or deterioration in their performance, could impair each company's ability to process transactions for its travelers and decrease the quality of service that we can offer to our travelers. If we were to experience frequent or persistent system failures, our reputation and brands

could be harmed.

In addition, we do not have backup systems for certain critical aspects of our operations, many other systems are not fully redundant and our disaster recovery planning may not be sufficient. Fire, flood, power

Table of Contents

loss, telecommunications failure, break-ins, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins and similar events or disruptions may damage or interrupt computer or communications systems at any time. Any of these events could cause system interruption, delays and loss of critical data, and could prevent us from providing services to our travelers and/or third parties for a significant period of time. Remediation may be costly and we may not have adequate insurance to cover such costs. Moreover, the costs of enhancing infrastructure to attain improved stability and redundancy may be time consuming and expensive and may require resources and expertise that are difficult to obtain.

Our expansion places a significant strain on our management, technical, operational and financial resources.

We have rapidly and significantly expanded our operations both domestically and internationally and anticipate expanding further to pursue growth of our product and service offerings and customer base. Such expansion increases the complexity of our business and places a significant strain on our management, operations, technical performance, financial resources and internal financial control and reporting functions.

There can be no assurance that we will be able to manage our expansion effectively. Our current and planned personnel, systems, procedures and controls may not be adequate to support and effectively manage our future operations, especially as we employ personnel in multiple geographic locations. We may not be able to hire, train, retain, motivate and manage required personnel, which may limit our growth. If any of this were to occur, it could damage our reputation, limit our growth, negatively affect our financial performance, and hurt our business.

Acquisitions could result in operating and financial difficulties.

Our future growth may depend, in part, on acquisitions. To the extent that we grow through acquisitions, we will face the operational and financial risks that commonly accompany that strategy. We would also face operational risks, such as failing to assimilate the operations and personnel of the acquired businesses, disrupting their ongoing businesses, impairing management resources and their relationships with employees and travelers as a result of changes in their ownership and management. Further, the evaluation and negotiation of potential acquisitions, as well as the integration of an acquired business, may divert management time and other resources. Some acquisitions may not be successful and their performances may result in the impairment of their carrying value.

Certain financial and operational risks related to acquisitions that may have a material impact on our business are:

Use of cash resources and incurrence of debt and contingent liabilities in funding acquisitions;

Amortization expenses related to acquired intangible assets and other adverse accounting consequences;

Costs incurred in identifying and performing due diligence on potential acquisition targets that may or may not be successful;

Difficulties and expenses in assimilating the operations, products, technology, information systems or personnel of the acquired company;

Impairment of relationships with employees, suppliers and affiliates of our business and the acquired business;

The assumption of known and unknown debt and liabilities of the acquired company;

Entrance into markets in which we have no direct prior experience; and

Impairment of goodwill or other intangible assets arising from our acquisitions (for example, in the quarter ended September 30, 2006, we recognized a \$47.0 million impairment charge related to an indefinite lived intangible asset of Hotwire).