HOMEAWAY INC
Form 10-Q
April 30, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

or

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

For the transition period from_________ to _________

Commission File Number: 001-35215

HomeAway, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-0970381**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1011 W. Fifth Street, Suite 300

Austin, Texas 78703

(Address of principal executive offices, including zip code)

(512) 684-1100

(Registrant s telephone number, including area code)

Indicate by check mark whether 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of stock, as of the latest practicable date.

Class	**Outstanding at April 23, 2013**
Common Stock, $0.0001 par value per share	**84,937,366**

HomeAway, Inc.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

HomeAway, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except for share and per share information)

(unaudited)

	March 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 187,246	$ 189,478
Short-term investments	127,141	80,330
Accounts receivable, net of allowance for doubtful accounts of $585 and $633 as of March 31, 2013 and December 31, 2012, respectively	17,954	16,343
Income tax receivable	766	775
Prepaid expenses and other current assets	8,095	7,312
Restricted cash	173	284
Deferred tax assets	5,355	5,425
Total current assets	346,730	299,947
Property and equipment, net	34,908	32,901
Goodwill	308,635	312,412
Intangible assets, net	56,117	59,727
Restricted cash	574	230
Deferred tax assets	2,126	1,807
Other non-current assets	19,195	15,651
Total assets	$ 768,285	$ 722,675
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 6,722	$ 6,613
Income tax payable	9,134	11,137
Accrued expenses	31,683	33,856
Deferred revenue	147,039	126,351
Total current liabilities	194,578	177,957
Deferred revenue, less current portion	2,672	2,879
Deferred tax liabilities	16,756	17,615
Other non-current liabilities	8,119	7,191
Total liabilities	222,125	205,642
Commitments and contingencies (Note 5)		
Stockholders equity		
	8	8

Common stock: $0.0001 par value; 350,000,000 shares authorized; 84,767,715 and 83,441,153 shares issued and outstanding as of March 31, 2013 and December 31, 2012, respectively		
Additional paid-in capital	647,053	618,700
Accumulated other comprehensive loss	(9,971)	(5,450)
Accumulated deficit	(90,930)	(96,225)
Total stockholders equity	546,160	517,033
Total liabilities and stockholders equity	$ 768,285	$ 722,675

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

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HomeAway, Inc.

Condensed Consolidated Statements of Operations

(In thousands, except for per share information)

(unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Revenue:		
Listing	$ 66,831	$ 53,968
Other	12,633	10,135
Total revenue	79,464	64,103
Costs and expenses:		
Cost of revenue (exclusive of amortization shown separately below)	13,281	10,532
Product development	12,399	9,702
Sales and marketing	26,367	24,734
General and administrative	16,049	12,837
Amortization expense	3,180	2,448
Total costs and expenses	71,276	60,253
Operating income	8,188	3,850
Other income (expense):		
Interest income	243	169
Other income (expense)	(1,591)	(728)
Total other income (expense)	(1,348)	(559)
Income before income taxes	6,840	3,291
Income tax expense	(1,545)	(890)
Net income	$ 5,295	$ 2,401
Net income per share:		
Basic and diluted	$ 0.06	$ 0.03
Weighted average number of shares outstanding:		
Basic	83,940	81,353
Diluted	86,492	84,500

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

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HomeAway, Inc.

Condensed Consolidated Statements of Comprehensive Income

(In thousands)

(unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income	$ 5,295	$ 2,401
Other comprehensive income:		
Foreign currency translation adjustments	(4,419)	1,676
Change in unrealized gains (losses) on short-term investments, net of tax	(102)	262
Total other comprehensive income (loss), net of tax	(4,521)	1,938
Comprehensive income	$ 774	$ 4,339

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

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HomeAway, Inc.

Consolidated Statement of Changes in Stockholders Equity

(In thousands)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders Equity
Balance at December 31, 2012	83,441	$ 8	$ 618,700	$ (5,450)	$ (96,225)	$ 517,033
Issuance of stock under Company plans, net of shares withheld for taxes	1,327		19,539			19,539
Stock compensation expenses			7,456			7,456
Excess tax benefits related to employee stock options			1,358			1,358
Other comprehensive loss				(4,521)		(4,521)
Net income					5,295	5,295
Balance at March 31, 2013	84,768	$ 8	$ 647,053	$ (9,971)	$ (90,930)	$ 546,160

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

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HomeAway, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Three Months Ended March 31, 2013	2012
Cash flows from operating activities		
Net income	$ 5,295	$ 2,401
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,044	2,455
Amortization of intangible assets	3,180	2,448
Amortization of premiums on securities and other	801	562
Stock-based compensation	7,456	5,198
Excess tax benefit from stock-based compensation	(1,358)	(603)
Deferred income taxes	(1,218)	3,514
Net realized/unrealized foreign exchange gain	(16)	(654)
Realized loss on foreign currency forwards	1,259	1,328
Changes in operating assets and liabilities, net of assets and liabilities assumed in business combinations:		
Accounts receivable	(1,880)	(813)
Income tax receivable	(347)	
Prepaid expenses and other assets	(1,378)	(6,464)
Accounts payable	(258)	3,114
Accrued expenses	(406)	436
Income tax payable	(4)	(3,043)
Deferred revenue	22,300	20,177
Deferred rent and other non-current liabilities	1,011	3,304
Net cash provided by operating activities	37,481	33,360
Cash flows from investing activities		
Change in restricted cash	(247)	313
Cash paid for trademarks and other assets acquired	(30)	(45)
Cash paid for non-marketable equity investment	(3,667)	
Purchases of short-term investments	(62,713)	(9,258)
Proceeds from maturities of marketable securities	15,000	11,457
Net settlement of foreign currency forwards	(1,259)	(1,328)
Purchases of property and equipment	(5,505)	(5,809)
Net cash used in investing activities	(58,421)	(4,670)
Cash flows from financing activities		
Proceeds from exercise of options to purchase common stock	19,539	10,937
Excess tax benefit from stock-based compensation	1,358	603
Net cash provided by financing activities	20,897	11,540
Effect of exchange rate changes on cash	(2,189)	990
Net (decrease) increase in cash and cash equivalents	(2,232)	41,220

Cash and cash equivalents at beginning of period	189,478	118,208
Cash and cash equivalents at end of period	$ 187,246	$ 159,428
Cash paid for taxes	$ 1,795	$ 2,634

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

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HomeAway, Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

1. Description of Business

HomeAway, Inc. (the Company) operates an online vacation rental property marketplace that enables property owners and managers to market properties available for rental to vacation travelers who rely on the Company s websites to search for and find available properties. These property owners and managers pay the Company to publish detailed property listings, including photographs, descriptions, location, pricing, availability and contact information. The Company sells complementary products as well, including travel guarantees, insurance products and property management software and services. Travelers use the network of websites to search for vacation rentals that meet their desired criteria, including location, size and price. Travelers that find properties that meet their requirements through the Company s marketplace are able to contact property owners and managers directly by phone or through form-based communication tools on the Company s websites.

The Company is a Delaware corporation headquartered in Austin, Texas.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of HomeAway, Inc. and all of its wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission, or the SEC. All significant intercompany transactions and balances have been eliminated in consolidation. In the opinion of the Company s management, the accompanying interim unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of normal recurring adjustments and those items discussed in these Notes, necessary for a fair presentation of the Company s financial position, as of March 31, 2013, the results of operations for the three months ended March 31, 2013 and March 31, 2012, the comprehensive income for the three months ended March 31, 2013 and March 31, 2012, the cash flows for the three months ended March 31, 2013 and March 31, 2012, and stockholders equity for the three months ended March 31, 2013. Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012. Operating results for this interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or for any other period.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. These differences could have a material effect on the Company s future results of operations and financial position. Significant items subject to those estimates and assumptions include certain revenue, allowance for doubtful accounts, fair value of short-term investments, carrying amounts of goodwill and other indefinite-lived intangible assets, depreciation and amortization, valuation of stock options and deferred income taxes.

Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the comparability of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

Level 1: Valuations based on quoted prices for identical assets and liabilities in active markets.

Level 2: Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Valuations based on unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

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The following section describes the valuation methodologies used to measure certain financial assets and financial liabilities at fair value.

Money Market Funds and Short-Term Investments

The Company s cash equivalents, restricted cash and short-term investments that are classified as Level 1 are valued using quoted prices generated by market transactions involving identical assets. Short-term investments classified as Level 2 are valued using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments in active markets; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. The Company did not hold any cash equivalents, restricted cash or short-term investments categorized as Level 3 as of March 31, 2013 or December 31, 2012.

Short-term investments include certificates of deposit, corporate bonds, U.S. government agency bonds and municipal bonds and are classified as available-for-sale and reported at fair value using the specific identification method. Unrealized gains and losses are excluded from earnings and reported as a component of other comprehensive income (loss), net of related estimated tax provisions or benefits. Additionally, the Company periodically assesses whether an other than temporary impairment loss on investments has occurred due to declines in fair value or other market conditions. Declines in fair value that are considered other than temporary are recorded as an impairment of investments in the consolidated statement of operations. The Company did not record any impairments of its investments for any of the periods presented.

The carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued liabilities and deferred revenue approximate fair value because of the relatively short maturity of these instruments.

The following table summarizes the basis used to measure certain financial assets and liabilities at fair value on a recurring basis in the Company s consolidated balance sheets at March 31, 2013 (in thousands):

	Balance as of March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents				
Money market funds	$ 98,129	$ 98,129	$	$
Total cash equivalents	98,129	98,129		
Restricted cash				
Money market funds	747	747		
Total cash equivalents	747	747		
Short-term investments				
Certificates of deposit	1,808		1,808	
Corporate bonds	96,934		96,934	
U.S. government agency bonds	1,011		1,011	
Municipal bonds	27,388		27,388	
Total short-term investments	127,141		127,141	
Total financial assets	$ 226,017	$ 98,876	$ 127,141	$

The following table summarizes the basis used to measure certain financial assets and liabilities at fair value on a recurring basis in the Company s consolidated balance sheets at December 31, 2012 (in thousands):

	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents				
Money market funds	$ 136,314	$ 136,314	$	$
Total cash equivalents	136,314	136,314		
Restricted cash				
Money market funds	514	514		
Total cash equivalents	514	514		
Short-term investments				
Certificates of deposit	502		502	
Corporate bonds	66,989		66,989	
U.S. government agency bonds	1,013		1,013	
Municipal bonds	11,826		11,826	
Total short-term investments	80,330		80,330	
Total financial assets	$ 217,158	$ 136,828	$ 80,330	$

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Business Segment

The Company has one operating segment consisting of various products and services related to its online marketplace of rental listing websites. The Company s chief operating decision maker is considered to be the Chief Executive Officer. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the single operating segment level.

Cash and Cash Equivalents

Cash and cash equivalents include investments in money market funds and certificates of deposit that are readily convertible into cash. Cash and cash equivalents are stated at cost, which approximates fair value. The Company considers all highly liquid investments purchased with an original maturity date of three months or less to be cash equivalents. Cash and cash equivalents consisted of the following at March 31, 2013 and December 31, 2012 (in thousands):

	March 31, 2013	December 31, 2012
Demand deposit accounts	$ 89,117	$ 53,164
Money market funds	98,129	136,314
Total	$ 187,246	$ 189,478

Restricted Cash

Restricted cash of $747,000 and $514,000 at March 31, 2013 and December 31, 2012, respectively, was held in a money market fund owned by the Company in conjunction with leased office space and to secure credit card availability and reimbursable direct debits due from the Company.

Short-term Investments

Short-term investments generally consist of marketable securities that have original maturities greater than ninety days as of the date of purchase. Investments in which the Company has the ability and intent, if necessary, to liquidate in order to support its current operations, including those with contractual maturities greater than one year from the date of purchase, are classified as short-term. The Company s investment securities are classified as available-for-sale and are presented at estimated fair value with any unrealized gains and losses included in other comprehensive income (loss). Cash flows from purchases, sales and maturities of available-for-sale securities are classified as cash flows from investing activities and reported gross, including any related premiums or discounts. Premiums related to purchases of available-for-sale securities were $4,048,000 and $378,000 during the three months ended March 31, 2013 and 2012, respectively. Fair values are based on quoted market prices. Short-term investments consisted of the following at March 31, 2013 and December 31, 2012 (in thousands):

	March 31, 2013			
	Gross Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificates of deposit	$ 1,812	$	$ (4)	$ 1,808
Corporate bonds	96,950	104	(120)	96,934
U.S. government agency bonds	1,009	2		1,011
Municipal bonds	27,391	16	(19)	27,388
Total short-term investments	$ 127,162	$ 122	$ (143)	$ 127,141

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	December 31, 2012			
	Gross Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificates of deposit	$ 502	$	$	$ 502
Corporate bonds	66,918	116	(45)	66,989
U.S. government agency bonds	1,011	2		1,013
Municipal bonds	11,817	9		11,826
Total short-term investments	$ 80,248	$ 127	$ (45)	$ 80,330

The following table summarizes the contractual underlying maturities of the Company s short-term investments at March 31, 2013 and December 31, 2012 (in thousands):

	March 31, 2013		
	Less than 12 Months	12 Months or Greater	Total
Certificates of deposit	$	$ 1,808	$ 1,808
Corporate bonds	36,208	60,726	96,934
U.S. government agency bonds		1,011	1,011
Municipal bonds	10,236	17,152	27,388
Total short-term investments	$ 46,444	$ 80,697	$ 127,141

	December 31, 2012		
	Less than 12 Months	12 Months or Greater	Total
Certificates of deposit	$ 3	$ 499	$ 502
Corporate bonds	41,307	25,682	66,989
U.S. government agency bonds		1,013	1,013
Municipal bonds	8,249	3,577	11,826
Total short-term investments	$ 49,559	$ 30,771	$ 80,330

At March 31, 2013 and December 31, 2012, the Company held no short-term investments with maturities greater than two years.

Non-marketable Equity Investment

During the three months ended March 31, 2013, the Company invested $3,667,000 for a non-controlling equity investment in a privately-held company in China. As of March 31, 2013, the total carrying value of the Company s investment in the privately-held company was $10,113,000. The Company s investment in the privately-held company is reported using the cost method of accounting or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. It was not practicable to estimate the fair value of this asset. No event or circumstance indicating an other-than-temporary decline in value of the Company s interest in the non-marketable equity investment was identified. This investment is recorded in other non-current assets on the consolidated balance sheets.

Accounts Receivable

Accounts receivable are primarily generated from three sources. Amounts due from credit card merchants who process the Company s credit card sales from property listings and remit the proceeds to the Company are the primary source of accounts receivable. Accounts receivable are also generated from Internet display advertising amounts due in the ordinary course of business as well as amounts due to the Company for property listings or other products purchased on account. Accounts receivable from Internet display advertising revenue and products purchased on account are recorded at the invoiced amount and are non-interest bearing. Accounts receivable outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance for doubtful accounts by estimating losses on receivables based on known troubled accounts and historical experiences of losses incurred.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Computer equipment and purchased software are generally depreciated over three years. Furniture and fixtures are generally depreciated over five to ten years. Leasehold improvements are depreciated on a straight-line basis over the shorter of the contractual lease period or their useful life. Upon disposal, property and equipment and the related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in the statements of operations. Ordinary maintenance and repairs are charged to expense, while expenditures that extend the physical or economic life of the assets are capitalized.

The Company capitalizes certain internally developed software and website development costs. These capitalized costs were approximately $25,786,000 and $23,985,000 at March 31, 2013 and December 31, 2012, respectively, and are included in property and equipment, net, in the balance sheet with depreciation expense in the three months ended March 31, 2013 and 2012 of approximately $732,000 and $827,000, respectively. The internally developed software costs are generally depreciated over five years.

Goodwill and Intangible Assets

Goodwill arises from business combinations and is measured as the excess of the purchase consideration over the sum of the acquisition-date fair values of tangible and identifiable intangible assets acquired, less any liabilities assumed.

Goodwill and intangible assets deemed to have indefinite useful lives, such as certain trade names, are not amortized and are subject to annual impairment tests or whenever events or circumstances indicate impairment may have occurred. Tests for impairment of goodwill and indefinite-lived intangible assets are performed on an annual basis as of October 1 or at any other time that events occur or circumstances indicate that the carrying amount of goodwill may not be recoverable.

Circumstances that could trigger an impairment test outside of the annual test include but are not limited to: a significant adverse change in the business climate or legal factors; adverse cash flow trends; an adverse action or assessment by a regulator; unanticipated competition; loss of key personnel; decline in stock price; and results of testing for recoverability of a significant asset group within a reporting unit. The Company determined that no triggering event occurred during any of the periods presented.

For goodwill and indefinite lived intangible assets, the Company completes what is referred to as the Step 0 analysis, which involves evaluating qualitative factors, including macroeconomic conditions, industry and market considerations, cost factors, and overall financial performance related to its goodwill and its indefinite lived intangible assets. If the Company s Step 0 analysis indicates that it is more likely than not that the fair value of a reporting unit or of an indefinite lived intangible asset is less than carrying amount, then the Company would perform a quantitative two-step impairment test. The quantitative analysis compares the fair value of the Company s reporting unit or indefinite-lived intangible assets to the carrying amount, and an impairment loss is recognized equivalent to the excess of the carrying amount over the fair value. If, after assessing the totality of events or circumstances, the Company determines that it is not more likely than not that the fair value of a reporting unit or indefinite lived intangible asset is less than its carrying amount, then the quantitative impairment tests are unnecessary.

The Company s annual evaluation of goodwill and indefinite-lived intangible assets for impairment was as of October 1, 2012, and the Company determined that the quantitative tests were not necessary.

The determination of whether or not goodwill or indefinite-lived intangible assets have become impaired involves a significant level of judgment in the assumptions underlying the approach used to determine the fair value of the reporting unit or intangible assets. Changes in the Company s strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded amounts of goodwill or intangible assets.

No impairment of goodwill or indefinite-lived intangible assets was identified in any of the periods presented.

Identifiable intangible assets consist of trade names, customer listings, technology, domain names and contractual non-compete agreements associated with acquired businesses. Intangible assets with finite lives are amortized over their estimated useful lives on a straight-line basis and reviewed for impairment whenever events or changes in circumstances indicate that an asset s carrying value may not be recoverable (see Note 3). The straight-line method of amortization represents the Company s best estimate of the distribution of the economic value of the identifiable intangible assets.

Impairment of Long-lived Assets

The Company evaluates long-lived assets held for use, such as property and equipment, for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated future undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value in the period in which the determination is made. No impairments of long-lived assets have been recorded during any of the periods presented.

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Revenue Recognition

The Company recognizes revenue when persuasive evidence of an agreement exists, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured.

The Company generates a significant portion of its revenue from customers that pay fees for online advertising listing services related to the listing of their properties for rent, primarily on a subscription basis over a fixed-term. The Company also generates revenue from fees based on the number of traveler inquiries and reservation bookings, local and national Internet display advertisers, license of property management software and ancillary products and services.

Payments for term-based subscriptions received in advance of services being rendered are recorded as deferred revenue and recognized ratably on a straight-line basis over the listing period. Revenue for inquiry-based contracts are determined on a fixed fee-per-inquiry as stated in the arrangement and recognized when the service has been performed.

Internet display advertising revenue is generated primarily from advertisements appearing on the Company s websites. There are several types of Internet advertisements, and the way in which advertising revenue is earned varies among them. Depending upon the terms, revenue might be earned each time an impression is delivered, each time a user clicks on an ad, each time a graphic ad is displayed, or each time a user clicks-through on the ad and takes a specified action on the destination site. The Company recognizes advertising revenue on a cost-per-thousand (CPM) impression basis whereby advertisers pay the Company based on the number of times their ads appear on the Company s websites.

The Company sells gift cards with no expiration dates to travelers and does not charge administrative fees on unused cards. There is a portion of the gift card obligation that, based on historical redemption patterns, will not be used or required to be remitted to relevant jurisdictions, or breakage. At the point of sale, the Company recognizes breakage as deferred revenue and amortizes it over 48 months based on historical redemption patterns. The Company also records commission revenue for each gift card sale over the same 48-month redemption period.

The Company earns a commission for online reservations revenue calculated as a percentage of the value of the reservation. This revenue is earned as the customers refund privileges lapse and is included in other revenue in the consolidated statement of operations.

Through its professional software for bed and breakfasts and professional property managers, the Company makes selected, online bookable properties available to online travel agencies and channel partners. The Company receives a percentage of the transaction value or a fee from the property manager for making this inventory available, which is recognized when earned. This revenue is included in other revenue in our consolidated statement of operations.

The Company generates revenue from the licensing of software products, the sale of maintenance agreements and the sale of hosted software solutions. For software license sales, one year of maintenance is typically included as part of the initial purchase price of the bundled offering with annual renewals of the maintenance component of the agreement following in subsequent years.

The Company recognizes revenue from the sale of perpetual licenses upon delivery, which generally occurs upon electronic transfer of the license key that makes the product available to the purchaser.

As software is usually sold with maintenance, the amount of revenue allocated to the software license is determined by allocating the fair value of the maintenance and subtracting it from the total invoice or contract amount. Vendor-specific objective evidence, or VSOE, of the fair value of maintenance services is determined by the standard published list pricing for maintenance renewals, as the Company generally charges list prices for maintenance renewals. In determining VSOE, the Company requires that a substantial majority of the selling price for maintenance services fall within a reasonably narrow pricing range. Maintenance and support revenue is recognized ratably over the term of the agreement beginning on the activation date. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Sales of hosted software solutions are generally for a one-year period. Revenue is recognized on a straight-line basis over the contract term. Certain implementation services related to the hosting services are essential to the customer s use of the hosting services. For sales of these hosting services where the Company is responsible for implementation, the Company recognizes implementation revenue ratably over the estimated period of the hosting relationship, which the Company considers to be three years. Recognition starts once the product has been activated.

Training and consulting revenue is recognized upon delivery of the training course or consulting services to the end customer.

The Company accounts for sales incentives to customers as a reduction of revenue at the time that the revenue is recognized from the related product sale. The Company also reports revenue net of any sales tax collected.

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Stock-Based Compensation

The cost of stock-based compensation is recognized in the financial statements based upon the estimated grant date fair value of the awards measured using the Black Scholes valuation model. The fair value of restricted stock awards and units is determined based on the number of shares granted and the fair value of the Company s common stock as of the grant date. Fair value is generally recognized as an expense on a straight-line basis, net of estimated forfeitures, over the employee requisite service period. When estimating forfeitures, the Company considers voluntary termination behaviors as well as trends of actual option forfeitures.

The Company uses the with and without approach in determining the order in which tax attributes are utilized. As a result, the Company only recognizes a tax benefit from stock-based awards in additional paid-in capital if an incremental tax benefit is realized after all other tax attributes currently available to the Company have been utilized. When tax deductions from stock-based awards are less than the cumulative book compensation expense, the tax effect of the resulting difference (shortfall) is charged first to additional paid-in capital to the extent of the Company s pool of windfall tax benefits with any remainder recognized in income tax expense. The Company has determined that it has a sufficient windfall pool available and therefore no amounts have been recognized in income tax expense. In addition, the Company accounts for the indirect effects of stock-based awards on other tax attributes through the consolidated statements of operations.

The benefits of tax deductions in excess of recognized compensation costs are reported as financing cash flows, but only when such excess tax benefits are realized by a reduction to current taxes payable. The Company recognized a tax benefit of approximately $1,358,000 and $603,000 during the three months ended March 31, 2013 and 2012, respectively, from the exercise of stock options. This tax benefit has been recorded as additional paid-in capital on the Company s consolidated balance sheets as of March 31, 2013 and December 31, 2012.

Income Taxes

The Company recognizes income taxes using an asset and liability approach. This approach requires the recognition of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company s consolidated financial statements or tax returns. The measurement of deferred taxes is based on provisions of the enacted tax law and the effects of future changes in tax laws or rates are not anticipated.

A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Evaluating the need for an amount of a valuation allowance for deferred tax assets requires significant judgment and analysis of all the positive and negative evidence available, including past operating results, estimates of future taxable income, reversals of existing taxable temporary differences and the feasibility of tax planning in order to determine whether all or some portion of the deferred tax assets will not be realized. Based on the available evidence and judgment, the Company has determined that it is more likely than not that certain loss carryforwards will not be realized; therefore, the Company has established a valuation allowance for such deferred tax assets to reduce the loss carryforward assets to amounts expected to be utilized.

The Company may be subject to income tax audits by the respective tax authorities in any or all of the jurisdictions in which the Company operates. The Company is currently undergoing an audit at its subsidiary in Germany. Significant judgment is required in determining uncertain tax positions. The Company recognizes the benefit of uncertain income tax positions only if these positions are more likely than not to be sustained. Also, the recognized income tax benefit is measured at the largest amount that is more than 50% likely of being realized. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of an audit or the refinement of an estimate. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits as a component of income tax expense. The countries in which the Company may be subject to potential examination by tax authorities include the United States, Switzerland, the United Kingdom, Germany, France, Spain, the Netherlands, Brazil, Australia, Colombia and Thailand.

The calculation of the Company s tax liabilities involves the inherent uncertainty associated with the application of complex tax laws. As a multinational corporation, the Company conducts its business in many countries and is subject to taxation in many jurisdictions. The taxation of the Company s business is subject to the application of various and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The Company s effective tax rate is highly dependent upon the geographic distribution of its worldwide earnings or losses, the tax regulations and tax rates in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of its tax planning strategies. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation, and the evolution of regulations and court rulings. Consequently, taxing authorities may impose tax assessments or judgments against the Company that could materially impact its tax liability and/or its effective income tax rate. The Company believes it has adequately provided in its financial statements for additional taxes that it estimates may be assessed by the various taxing authorities. While the Company believes that it has adequately provided for all uncertain tax positions, amounts asserted by tax authorities could be greater or less than the Company s accrued position. These tax liabilities, including the interest and penalties, are adjusted pursuant to a settlement with tax authorities, completion of audit, refinement of estimates or expiration of various statutes of limitation.

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Foreign Currency Translation

The functional currency of the Company s foreign subsidiaries is generally their respective local currency. The financial statements of the Company s international operations are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders equity, and a weighted average exchange rate for each period for revenue, expenses, and gains and losses. Foreign currency translation adjustments are recorded as a separate component of stockholders equity. Gains and losses from foreign currency denominated transactions are recorded in other income (expense) in the Company s consolidated statements of operations. For the three months ended March 31, 2013 and 2012, the Company recorded transaction losses of approximately $1,535,000 and $751,000, respectively.

Derivative Financial Instruments

As a result of the Company s international operations, it is exposed to various market risks that may affect its consolidated results of operations, cash flows and financial position. These market risks include, but are not limited to, fluctuations in currency exchange rates. The Company s primary foreign currency exposures are in Euros and British Pound Sterling. As a result, the Company faces exposure to adverse movements in currency exchange rates as the financial results of its operations are translated from local currency into U.S. dollars upon consolidation. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in gains and losses that are reflected in other income (expense) in the Company s consolidated statements of operations.

The Company may enter into derivative instruments to hedge certain net exposures of nonfunctional currency denominated assets and liabilities, primarily related to intercompany loans, even though it does not elect to apply hedge accounting or hedge accounting does not apply. Gains and losses resulting from a change in fair value for these derivatives are reflected in the period in which the change occurs and are recognized on the consolidated statement of operations in other income (expense). Cash flows from these contracts are classified within net cash provided by operating activities on the consolidated statements of cash flows.

The Company does not use financial instruments for trading or speculative purposes. The Company recognizes all derivative instruments on the balance sheet at fair value and its derivative instruments are generally short-term in duration. Derivative contracts outstanding were not material as of March 31, 2013 or December 31, 2012. The Company is exposed to the risk that counterparties to derivative contracts may fail to meet their contractual obligations.

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is computed by dividing net income by the weighted average common shares outstanding plus potentially dilutive common shares.

Restricted stock awards provide the holder of unvested shares the right to participate in dividends declared on the Company s common stock. Accordingly, these shares are included in the weighted average shares outstanding for the computation of basic earnings per share in periods of undistributed earnings. Restricted stock awards are excluded from the basic earnings per share in periods of undistributed losses as the holders are not contractually obligated to participate in the losses of the Company. Unvested restricted stock units do not provide the holder the right to participate in dividends declared on the Company s common stock. Accordingly, these shares are excluded in the weighted average shares outstanding for the computation of basic earnings per share in periods of undistributed earnings or losses.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss), cumulative foreign currency translation adjustments, and unrealized gains and losses on available-for-sale securities.

Recent Accounting Pronouncements

In January 2013, the Financial Accounting Standards Board (FASB) issued amended guidance that enhances disclosure requirements about the nature of an entity s right to offset and related arrangements associated with its derivative instruments, repurchase agreements, and securities lending transactions. This new guidance requires the disclosure of the gross amounts subject to rights of offset, amounts offset in accordance with the accounting standards followed, and the related net exposure. This new guidance is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. This guidance did not have a material impact on the Company s financial position, results of operations, or cash flows since it is an enhancement to current required disclosures.

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In February 2013, the FASB issued new accounting guidance that improves the reporting of reclassifications out of accumulated other comprehensive income. This new guidance requires entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income when applicable or to cross-reference the reclassifications with other disclosures that provide additional detail about the reclassifications made when the reclassifications are not made to net income. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2012. This guidance did not have a material impact on the Company s financial position, results of operations, or cash flows since it is an enhancement to current required disclosures.

3. Goodwill and Other Intangible Assets

Goodwill

Changes in the Company s goodwill balance for the year ended December 31, 2012 and the three months ended March 31, 2013 are summarized in the table below (in thousands):

Balance at December 31, 2011	$ 301,015
Acquired in business combinations	11,190
Foreign currency translation adjustment	207
Balance at December 31, 2012	312,412
Foreign currency translation adjustment	(3,777)
Balance at March 31, 2013	$ 308,635

Intangible Assets

The Company s intangible assets, excluding goodwill, consist of intangible assets acquired primarily in business combinations and were recorded at their estimated fair values on the date of acquisition. The finite-lived intangible assets that are being amortized are summarized in the table below (in thousands):

		March 31, 2013			December 31, 2012		
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trade names and trademarks	10	$ 23,811	$ (3,077)	$ 20,734	$ 24,000	$ (2,474)	$ 21,526
Developed technology	2-8	26,063	(21,322)	4,741	26,435	(20,983)	5,452
Customer relationships	6-13	59,690	(36,515)	23,175	60,321	(35,124)	25,197
Noncompete agreements and domain names	2-5	3,376	(2,938)	438	3,376	(2,853)	523
Total		$ 112,940	$ (63,852)	$ 49,088	$ 114,132	$ (61,434)	$ 52,698

Amortization of non-compete agreements is recorded over the term of the agreements.

Amortization expense for the three months ended March 31, 2013 and 2012 was approximately $3,180,000 and $2,448,000, respectively.

The Company has the following indefinite-lived intangible assets recorded in its consolidated balance sheet as of March 31, 2013 and December 31, 2012, respectively (in thousands):

	March 31, 2013	December 31, 2012
Trademarks, trade names and other	$ 7,029	$ 7,029

4. Accrued Expenses

The Company s accrued expenses are comprised of the following at March 31, 2013, and December 31, 2012 (in thousands):

	March 31, 2013	December 31, 2012
Compensation and related benefits	$ 12,481	$ 16,828
Gift cards	5,298	5,655
Taxes	3,870	3,362
Advertising	3,426	1,130
Other	6,608	6,881
Total	$ 31,683	$ 33,856

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5. Commitments and Contingencies

Leases

The Company leases its facilities and certain office equipment under non-cancellable operating leases. Rental expense was approximately $1,231,000 and $1,004,000 for the three months ended March 31, 2013 and 2012, respectively.

Guarantees

The Company offers two guarantee products to travelers: Basic Rental Guarantee and Carefree Rental Guarantee. The Basic Rental Guarantee is offered to travelers that book a vacation rental property listed on any one of the Company s websites to protect 50% of their vacation rental payments up to $1,000 against Internet fraud. Travelers may also purchase additional protection to cover 100% of vacation rental payments up to $10,000 against Internet fraud, misrepresentation, wrongful denial of entry, wrongful deposit loss or, beginning in 2012, losses from phishing claims by the purchase of the Carefree Rental Guarantee. The Company does not maintain insurance from any third party for claims under these guarantees, and any amounts payable for claims made under these guarantees are payable by the Company. Amounts recorded for estimated future claims under the guarantees are based on historical experience and estimates of potential future claims made by the Company are recorded either in cost of revenue or in general and administrative expense in the Company s consolidated statement of operations depending on whether the expense is related to estimated claims under the Basic Rental Guarantee or to the Carefree Rental Guarantee.

Expected future claims for the traveler guarantees, which are presented as a current liability in the Company s consolidated balance sheets, and changes for the guarantees are as follows (in thousands):

Traveler guarantee liability at December 31, 2011	$ 247
Costs accrued for new vacation rentals	986
Guarantee obligations honored	(667)
Traveler guarantee liability at December 31, 2012	566
Costs accrued for new vacation rentals	556
Guarantee obligations honored	(374)
Traveler guarantee liability at March 31, 2013	$ 748

The Company maintains a guarantee of £5,000,000 (approximately $7,599,000 as of March 31, 2013) in favor of a bank in the United Kingdom for extending credit to the Company in connection with the wholly owned United Kingdom subsidiary s business of collecting its subscription revenues in advance via credit card payments.

Legal

From time to time, the Company is involved in litigation relating to claims arising in the ordinary course of business. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using available information. Views on estimated losses are developed by management in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. After taking all of the above factors into account, the Company determines whether an estimated loss from a contingency related to litigation should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. The Company further determines whether an estimated loss from a contingency related to litigation should be disclosed by assessing whether a material loss is deemed reasonably possible. Such disclosures will include an estimate of the additional loss or range of loss or will state that such an estimate cannot be made.

Management believes that there are no claims or actions pending or threatened against the Company, the ultimate disposition of which would have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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6. Stock-Based Compensation

During the three months ended March 31, 2013, the Company issued an aggregate of 363,673 restricted stock units under its 2011 Equity Incentive Plan, or 2011 Plan, for an aggregate fair value of $8,440,000. Additionally, the Company issued an aggregate of 222,746 options to purchase common stock under the 2011 Plan for an aggregate fair value of $2,593,000.

The following table summarizes the total stock-based compensation expense that the Company recorded for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cost of revenue	$ 845	$ 416
Product development	1,727	1,231
Sales and marketing	1,608	1,270
General and administrative	3,276	2,281
Total	$ 7,456	$ 5,198

7. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following at March 31, 2013 and December 31, 2012, respectively (in thousands):

	March 31, 2013	December 31, 2012
Foreign currency translation	$ (9,949)	$ (5,530)
Unrealized gains (losses) on short-term investments	(22)	80
Total	$ (9,971)	$ (5,450)

8. Income Taxes

For the three months ended March 31, 2013 and 2012, the Company recorded income tax expense of $1,545,000 and $890,000, respectively, resulting in an effective tax rate of 22.6% and 27.0%, respectively. At March 31, 2013, the Company s effective tax rate estimate for the year ended December 31, 2013 differed from the statutory rate primarily due to the benefit of disqualifying dispositions of incentive stock options, which is partially offset by non-deductible stock compensation charges, state taxes, the effect of different statutory tax rates in foreign jurisdictions and the federal research and experimentation tax credit. At March 31, 2012, the Company s effective tax rate estimate for the year ended December 31, 2012 differed from the statutory rate primarily due to the benefit of disqualifying dispositions of incentive stock options, which is partially offset by non-deductible stock compensation charges, state taxes and the effect of different statutory tax rates in foreign jurisdictions.

The federal research and experimentation tax credit was extended on January 2, 2013 by the signing of the American Taxpayer Relief Act of 2012, or the Act. The Act retroactively extended this tax credit from January 1, 2012 through December 31, 2013. Because the Act was enacted during 2013, an income tax benefit of $614,000 related to the 2012 research and experimentation tax credit is reflected as a discrete item in the Company s results of operations for the quarter ended March 31, 2013.

9. Net Income Per Share

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

	Three Months Ended March 31,	
	2013	2012
Numerator		
Net income	$ 5,295	$ 2,401
Denominator		
Weighted average common shares outstanding-basic	83,940	81,353
Dilutive effect of stock options, warrants and restricted stock units	2,552	3,147
Weighted average common shares outstanding-diluted	86,492	84,500
Net income per share basic and diluted	$ 0.06	$ 0.03

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The following common equivalent shares were excluded from the calculation of net income per share as their inclusion would have been anti-dilutive (in thousands):

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Stock options and warrants	2,990	4,197
Restricted stock units	61	13
Total common equivalent shares excluded	3,051	4,210

Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations

Safe Harbor Cautionary Statement

This quarterly report on Form 10-Q contains forward-looking statements that are based on our management s beliefs and assumptions and on information currently available to our management. The statements contained in this quarterly report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may be signified by terms such as anticipates, believes, could, seeks, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would or similar expressions and the negatives of those terms. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in other documents we file with the Securities and Exchange Commission. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management s beliefs and assumptions only as of the date of this quarterly report on Form 10-Q. You should read this quarterly report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

The following discussion should be read in conjunction with our interim condensed consolidated financial statements contained elsewhere in this quarterly report on Form 10-Q and in our other Securities and Exchange Commission, or SEC, filings including our Annual Report on Form 10-K for the year ended December 31, 2012 and subsequent reports on Form 8-K, which discuss our business in greater detail.

Overview

We operate the world s largest online marketplace for the vacation rental industry. Our marketplace brings together millions of travelers seeking vacation rentals online with hundreds of thousands of property owners and managers of vacation rental properties located in 171 countries around the world. Our portfolio includes leading vacation rental websites in the United States, the United Kingdom, Germany, France, Spain, Brazil and Australia. During the three months ended March 31, 2013, our websites attracted approximately 207 million website visits, and as of March 31, 2013, our global marketplace included more than 742,000 paid listings.

In the first quarter of 2013, we continued to focus our efforts on providing the largest selection of properties to travelers and the most qualified inquiries to property owners and managers, as we added over 43,000 paid listings, net of non-renewals, to our network from March 31, 2012 to March 31, 2013.

We continued to improve monetization of our listing base from pricing and product changes through continued adoption of our tiered pricing structure and increase in purchases by property owners and managers of bundled listings products. This improved monetization can be seen in the increase of our average revenue per listing from $322 in the first quarter of 2012 to $368 in the first quarter of 2013. Tiered pricing is currently available to new and renewing property owners and managers on HomeAway.com and VRBO.com in the United States, HomeAway.co.uk in the United Kingdom, Abritel.fr in France and HomeAway.de in Germany. It allows them to improve their position in search results by purchasing a higher subscription level or tier. We believe property owners and managers increasingly will elect to purchase higher tiers, which would increase overall average revenue per listing in future periods. At the same time, by keeping base prices low, we believe the number of paid listings can continue to grow. Although we plan to launch tiered pricing on our other websites as well, we may use different strategies as we enter new markets and geographies or attempt to further penetrate the professional property manager market.

Enablement of e-commerce on our websites has been and will continue to be a focus for our Company. In the first quarter of 2013, we continued to see adoption of our online payments platform, called ReservationManager , which is currently available on HomeAway.com and VRBO.com in the United States, HomeAway.co.uk in the United Kingdom, Abritel.fr in France and HomeAway.de in Germany. ReservationManager enables property owners and managers to respond to and manage inquiries, prepare and send rental quotes and payment invoices, allows travelers to book online, including the ability to enter into rental agreements online, and process online payments via credit card or eCheck. Additionally, through ReservationManager, property owners and managers can make value-added products such as property damage protection available for purchase. We believe that adoption of this product over time will allow us to earn more revenue from ancillary products while providing a more secure payment mechanism for travelers. We plan to introduce new products and services for travelers, property owners and managers, which we believe will provide further opportunities to generate revenue through our marketplace, including a pay-for-booking product for our property owners and managers.

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We believe that bringing travelers to our online marketplace is necessary to attract and retain vacation rental owners and managers. It is also critical for us to increase the rates at which travelers inquire about renting and book vacation rentals with our property owners and managers. To meet these challenges, we are focused on a combination of marketing tactics, including pay-per-click advertising, search engine optimization, and display advertising, with a goal of driving visits to our websites as well as increasing the exposure of the vacation rental category. We are also investing in product enhancements to make it easier for travelers visiting our websites to search and find the right property, to inquire and to book their stay. Online booking functionality is currently available on HomeAway.com and VRBO.com in the United States, HomeAway.co.uk in the United Kingdom, Abritel.fr in France and HomeAway.de in Germany. Online booking enables travelers to reserve a vacation rental directly on any of our listing websites that utilize our ReservationManager payments platform, rather than requiring correspondence with a property owner or manager to reserve a vacation rental.

Key Financial Highlights

We have achieved significant growth since our commercial launch in 2005. Our revenue growth is attributable to our acquisitions of other online listings businesses, the organic growth in the number of listings that property owners and managers purchase from us, increases in the average revenue we receive per listing due to additional features and price increases, and the introduction of additional products and services related to our marketplace. We view our market opportunity as global and have historically generated strong cash flows. Additionally, we have had predictable financial results because of our advance payment, subscription-based model and our high annual listing renewal rates.

Key financial highlights for the three months ended March 31, 2013 include the following:

- Total revenue was $79.5 million compared to $64.1 million in the first quarter of 2012, or an increase of 24.0%;
- Percentage of total revenue from outside the United States was 37.6% in the first quarter, compared to 37.3% in the first quarter of 2012, and in the three months ended March 31, 2013 included 35.6% from Europe and 2.0% from Brazil and Australia;
- Listing revenue was $66.8 million compared to $54.0 million in the first quarter of 2012 and contributed 84.1% of total revenue compared to 84.2% in the first quarter of 2012;
- Net income was $5.3 million compared to $2.4 million in the first quarter of 2012, or an increase of 120.5%;
- Cash from operating activities was $37.5 million compared to $33.4 million in the first quarter of 2012, or an increase of 12.4%;
- Adjusted EBITDA was $21.8 million compared to $14.0 million in the first quarter of 2012, or an increase of 56.1%; as a percentage of revenue, Adjusted EBITDA was 27.4%, an increase of approximately 560 basis points over 21.8% in the first quarter of 2012;
- Free cash flow was $33.3 million compared to $28.2 million in the first quarter of 2012, or an increase of 18.4%; on a trailing twelve month basis, free cash flow increased 21.3% to $90.4 million from $74.6 million in the comparable trailing twelve month period for the prior year;
- Pro forma net income was $12.2 million, or $0.14 per diluted share, compared to pro forma net income of $7.4 million, or $0.09 per diluted share, in the first quarter of 2012; and
- Cash, cash equivalents and short-term investments as of March 31, 2013 were $314.4 million.

For further discussion regarding Adjusted EBITDA, free cash flow and pro forma net income, along with reconciliations of such numbers to the most directly comparable financial measures calculated and presented in accordance with GAAP, please see the information under the caption Discussion Regarding Adjusted EBITDA, Free Cash Flow and Pro Forma Net Income and Reconciliation to GAAP in Item 2 of this Quarterly Report on Form 10-Q.

Acquisitions

Since our inception, we have acquired 18 businesses as part of our growth strategy. Each of these acquisitions has been accounted for using the acquisition method of accounting. Accordingly, the financial statements for these businesses have been included in our consolidated financial results since the applicable acquisition dates. The most recent acquisition was in April 2012, when we acquired Top Rural S.L. in Spain.

Our acquisitions have presented, and certain of them continue to present, significant integration challenges. They have required us to integrate new operations, offices and employees and to formulate and execute on marketing, product and technology strategies associated with the acquired businesses. In some cases, we continue to manage multiple brands and technology platforms of the acquired businesses, which has increased our cost of operations. Challenges of this nature are likely to arise if we acquire businesses in the future.

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Growth Opportunities and Trends

Our ability to continue to grow our revenue will depend largely on increasing the number of paid listings, increasing revenue per listing and increasing other revenue from other products and services through our marketplace. This includes our ability to successfully enable e-commerce transactions on our websites, including allowing for online payments and online booking, and commission-based revenue streams for vacation rental listings through the launch of pay-per-booking listings. We continually assess opportunities for strategic acquisitions. We also use direct and indirect marketing as well as telesales to reach owners and professional property managers. We believe that the growing awareness of vacation rentals, as a favorable alternative to hotels, has and will continue to support growth of our business.

We continue to monitor the weakened economic environment in Europe and the corresponding impact on our business. Traffic growth and inquiry growth remain strong in Europe. We believe that our ability to deliver high quality inquiries to our customers in spite of the broader economic challenges in Europe will help mitigate any potential negative visit trends to our websites. Additionally, we continue to monitor foreign exchange rates as declining foreign exchange rates will negatively impact our results given that 35.6% of our revenue was generated in Europe in the first quarter of 2013.

Expenses

Our expenses are primarily composed of salaries and related expenses, marketing and professional fees. Our expenses from quarter to quarter and year to year may fluctuate due to timing of specific events or projects. We will continue to increase expenses across the organization on an annual basis to support our growth and expect our cost of revenue to grow in absolute dollars and slightly as a percentage of revenue for the year ended December 31, 2013. We expect to incur higher expenses for product development as we record a full-year impact of personnel hired in 2012 and as we hire additional personnel to develop new features and products and expect product development expenses to increase as a percentage of revenue for the year ended December 31, 2013. We expect to incur higher expenses for sales and marketing as we continue to build our sales team to address the professional property managers and continue to build brand and category awareness, but expect sales and marketing expenses to decline as a percentage of revenue for the year ended December 31, 2013. We expect to incur higher expenses for general and administrative expenses to support the growth of our business and the requirements of being a publicly traded company, but expect general and administrative expenses to remain consistent as a percentage of revenue for the year ended December 31, 2013. We plan for additional capital investments for the year ended December 31, 2013 to support the growth of our business, but expect our investment in capital expenditures to remain consistent as a percentage of revenue as compared to the year ended December 31, 2012. We believe that reorganizing our global corporate structure will lower our tax expense over the longer term.

Key Business Metrics

In addition to traditional financial and operational metrics, we use the following business metrics to monitor and evaluate results.

	Three Months ended March 31,	
	2013	2012
Paid listings, end of period	742,299	699,088
Average revenue per listing	$ 368	$ 322
Renewal rate, end of period	73.6%	77.0%
Visits to websites (in millions)	207	160

Following the migration of VRBO.com to our global technology platform in 2012, property owners and managers that have listings on both HomeAway.com and VRBO.com are able to consolidate their listings into one listing that is displayed on both websites. Additionally, the platform consolidation allows property owners and managers to purchase bundled listings that include display on both HomeAway.com and VRBO.com. As a result, we now count these bundled listings as one listing. This impacts the comparability of our current period reported metrics to our previously reported historical metrics for paid listings, renewal rate and average revenue per listing.

As a result of consolidated listings and bundled listings, our paid listing counts will be lower since these listings previously would have been counted as two paid listings had they been purchased on both websites. In the future, as property owners and managers that have listings on both HomeAway.com and VRBO.com renew their subscriptions into a bundled listing, we will count these as one listing. We anticipate more bundled listings and consolidations of listings in the future, which we expect will lower our paid listing growth as compared to historical levels. The lower paid listing counts from consolidations and bundles will in turn increase our average revenue per listing and lower our reported renewal rate. Additionally, our bundled listing products generally have a higher base price and will increase our average revenue per listing.

Adjusting for the impact of our customers ability to consolidate listings and to purchase network product bundles, we estimate our business metrics to be as follows:

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	Three Months ended March 31, 2013
Paid listings, end of period	765,274
Average revenue per listing	$ 359
Renewal rate, end of period	74.9%

Paid Listings. In the three months ended March 31, 2013 and 2012, 84.1% and 84.2%, respectively, of our revenue was derived from paid listings. We regularly track paid listings as a key revenue growth indicator and to identify trends in our business and industry. From March 31, 2012 to March 31, 2013, paid listings increased by 6.2%, contributing to listing revenue growth of 23.8%. The growth in paid listings continued to be due to our marketing and selling new and additional subscription listings to professional property managers, as well as organic growth from property owners and managers who become aware of our websites and choose to market their properties. Growth in paid listings is also impacted by listings acquired in business combinations. Growth in new listings is partially offset by loss of listings through attrition.

Adjusting for the impact of consolidated listings and new bundled listings, we estimate that our paid listing growth would have been approximately 9.5% at March 31, 2013. We do not expect these changes to have any negative impact on the number of unique properties on our websites.

As the number of paid listings increases, we believe that we will generate additional revenue while also expanding the value of the marketplace to travelers, thus increasing the likelihood that travelers will find a property that is suitable to their needs. We define a paid listing as a fee to list a property advertisement on one or more websites in our marketplace. A paid listing allows a property owner or manager to include a description of the property, along with location, pricing, availability, a specified number of photos and contact information. We also provide tools to enable them to manage their listings and rental business. Most listings are sold on a subscription basis, and some listing packages may include listings on more than one of our websites. We also sell listings on a pay-for-performance basis to property managers. When purchased at the same time in one bundle, we count this as one paid listing.

It is possible that a specific property may be listed on more than one of our websites without indicating that the multiple listings refer to the same property. We have used various technologies to estimate the number of unique properties and are implementing systems and processes to identify the number of unique properties that comprise our paid listings, which we estimate was approximately 661,000 as of March 31, 2013, as compared to approximately 594,000 as of March 31, 2012.

Average Revenue per Listing. We believe that trends in revenue per listing, over an extended period, are important to understanding the value we bring to property owners and managers, and the overall health of our marketplace. We use trends in revenue per listing, as well as trends in paid listings, in order to formulate financial projections and make strategic business decisions. At a consolidated level, increases in revenue per listing may increase our earnings or may be leveraged for future investment. The average revenue per listing may fluctuate based on the timing and nature of acquisitions, changes in our pricing, uptake of listing enhancements, changes in the pricing of enhancements, changes in brand and listing type mix, and the impact of foreign exchange rates on our listing revenue outside of the United States.

From March 31, 2012 to March 31, 2013, average revenue per listing increased by 14.3%, which contributed to our overall listing revenue growth. Foreign exchange rates did not materially impact the average revenue per listing growth rate from March 31, 2012 to March 31, 2013. Average revenue per listing for subscriptions only, excluding the impact of foreign exchange rates and lower revenue per listing for pay-for-performance listings, grew 13.5% in the first quarter of 2013 as compared to the first quarter of 2012.

Adjusting for the impact of consolidated listings and new bundled listings on the number of paid listings, our average revenue per listing would have been $359 in the three months ended March 31, 2013, or an increase of 11.5%. Excluding the impact of foreign exchange rates and lower revenue per listing for pay-for-performance listings, and adjusting for the impact of consolidated listings and new bundled listings, our average revenue per subscription listing only would have been $384 in three months ended March 31, 2013 as compared to $348 in three months ended March 31, 2012, or an increase of 10.3%.

We compute average revenue per listing as annualized listing revenue divided by the average of paid listings at the beginning and end of the period. Our paid listings include both subscription listings and pay-for-performance listings to professional property managers. Average revenue per listing may be impacted by changes in mix between listing types, with pay-for-performance listings generally having a dilutive effect on average revenue per listing. The price of listings varies by website and can include various additional fees associated with listing enhancements.

We have traditionally relied on increases in base pricing to increase revenue per listing but are now focused on tiered pricing alternatives as well as bundled listings for our property owners and managers which may or may not include increases in our base price. We began offering tiered pricing on HomeAway.com in the United States in 2011, which allows our property owners and managers to purchase a higher subscription level to increase the position of their listings in search results. In 2012, we migrated VRBO.com in the United States to the same tiered pricing structure. Also in 2012, we launched tiered pricing on HomeAway.com.uk in the United Kingdom, Abritel.fr in France and HomeAway.de in

Germany. As we continue to implement tiered pricing on other websites, or change the prices or structure of tiered pricing, we may see an impact to listing sales in the current period with the impact on revenue seen over the length of the subscription period.

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Renewal Rate. Renewal of paid subscription listings is a key driver of revenue for our business. Also, we track renewal rate in order to understand and improve upon the satisfaction of our property owners and managers and to help us more accurately estimate our future revenue and cash flows. While our overall renewal rate decreased from 77.0% in the first quarter of 2012 to 73.6% in the first quarter of 2013, renewal rates vary among our websites and can fluctuate due to a variety of factors, including customer satisfaction, changes in our processes associated with renewal activity, such as the introduction of automatic renewal, and general market conditions.

Our renewal rate, after adjusting for the impact of consolidated and bundled listings, decreased from 77.0% at March 31, 2012 to 74.9% at March 31, 2013. This decline of 2.1% is primarily due to the inclusion of our Australian site, HomeAway.com.au, in the calculation for the first quarter of 2013; a decline in the renewal rates at Abritel.fr, one of our French websites, due largely to the migration of Abritel.fr to our global technology platform in the third quarter of 2011, which resulted in a change in renewal options for property owners and managers; the removal of listings for a large single account in the United Kingdom due to quality and performance concerns associated with the listings; and declines seen as a result of substantial product changes made during 2012 on VRBO.com in the United States. Our sequential quarterly renewal rates, after adjusting for the impacts of consolidated listings and bundled listings, increased from 74.4% at December 31, 2012 to 74.9% at March 31, 2013.

We expect continued product improvements, demand generation for property owners and managers and the resulting increases in customer satisfaction to result in long-term improvements to renewal rates. Our renewal rate was impacted and will be impacted in the future, by our property owners and managers ability to consolidate their listings in the U.S. and their ability to purchase geographic bundled listings.

The renewal rate for our subscription listings at the end of any period is defined as the percentage of those paid listings that were active at the end of the period ended twelve months prior that are still active as of the end of the reported period. We include most brands in our calculation of renewal rate. However, subscriptions to BedandBreakfast.com and Toprural.com remain excluded until we can further develop our database system. However, based on our review of other internal renewal rate data, we do not believe that the exclusion of these brands from the renewal rate calculation materially impacts the result. Property owners and managers satisfaction with our solutions is the primary driver of our renewal rate. We believe that property owners and managers measure their satisfaction with our websites based largely on the number of inquiries and rental bookings that they receive from travelers. When the underlying vacation properties are sold or taken off the market, the owner or manager has no further need for the listings, and this attrition is a natural and ongoing component of non-renewal of listings. We exclude pay-for-performance listings from our renewal rate analysis since they are not sold on a subscription basis.

Visits to Websites. We view visits to websites as a key indicator of growth in our brand awareness among users and our ability to provide our property owners and managers with inquiries from travelers. Growth in visits to websites will be driven by our marketing strategies and has an indirect impact on our financial performance. We use a variety of tools to measure visits to our websites. These tools include solutions from third parties such as Omniture and Google Analytics. We also review third-party published reports to measure our results against comparable companies; however, these reports are not consistent with our internal measurements.

Visits to websites increased by 29.7% in the first quarter of 2013 as compared to the first quarter of 2012. During the fourth quarter of 2012, we began using a different tool for the measurement of visits to certain of our websites. On a comparable basis, we estimate that visits to websites would have increased by 22.1% for the first quarter of 2013 as compared to the first quarter of 2012 if we had been using the same tools during both reporting periods.

Key Components of Our Results of Operations

Revenue

We derive most of our revenue from paid listings from our property owners and managers. Our customers generally pay for their listings at the beginning of the listing term, and revenue is recognized monthly over the term of the listing, which is generally one year. We offer pay-for-performance listings to professional managers, which represented 1.2% and 1.7% of our revenue in the three months ended March 31, 2013 and 2012, respectively. This offering is generally taken when a property manager has a marketing budget that is allocated over many managed properties. They can elect to list more properties and pay us each month for the number of inquiries that are generated.

A major source of new property listings has been our inside sales organization, which targets larger professional managers. We also generate new listings from search engines such as Google, where property owners and managers search to find vacation rental listings websites. In addition, word-of-mouth referrals, primarily from existing property owners and managers that have been successful in renting their vacation rentals or travelers who have been successful in finding a property to rent using our websites, are another source for new listings.

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We believe that in order to grow our revenue in the future, it will be important to introduce new features and functionality for our property owners and managers, allowing us to keep prices low while offering expanded distribution and search placement for additional fees. It will also be important for us to continually improve the functionality of our websites to attract a large audience of travelers to help ensure our property owners and managers receive sufficient inquiries and bookings.

Deferred revenue consists of payments received from sales of listings in excess of the revenue that we have recognized from the same listings, sales from hosted software solutions for which the estimated period of the hosting relationship is longer than one year and sales of gift cards for which revenue is recognized over a period commensurate with the use of the gift card. Deferred revenue increases as a result of new listings and decreases as a result of the recognition each month of the pro-rata share of revenue from cash collected in previous periods. We expect an increase in deferred revenue on an annual basis as we grow our core listing business, but may experience seasonal decreases in deferred revenue in quarters with fewer new listings and renewals, as is discussed in more detail in the Management s Discussion and Analysis of Financial Condition and Results of Operations Seasonality and Quarterly Results section of this Quarterly Report on Form 10-Q. As with other balance sheet line items, deferred revenue is reflected at the current month-end exchange rate, and the change in deferred revenue may therefore be impacted by movements in foreign currency.

We earn revenue from the sales of Internet display-based advertising on our websites, property management software licenses and related maintenance, gift cards and commissions for online reservations. We also offer other services to property owners, managers and travelers that result in revenue and royalties.

Costs and Expenses

A large component of our costs and expenses consists of personnel costs. Personnel costs include salaries, benefits, bonuses and related expenses, including stock-based compensation. We grew from 1,010 employees at March 31, 2012 to 1,308 at March 31, 2013. We expect that personnel costs will be higher in absolute dollars in 2013 than in 2012 based on an expected increase in the number of employees in 2013.

Cost of Revenue. Cost of revenue consists of customer service personnel and web-hosting personnel costs, merchant fees charged by credit card processors, costs associated with the hosting of our websites, costs associated with payments and reserves under our Carefree Rental Guarantee and depreciation costs. Personnel costs include salaries, benefits, bonuses and related expenses, including stock-based compensation. To the extent that the number of paid listings on our marketplace grows and as we add more features to our websites, we intend to invest additional resources in customer service systems and personnel. Our customer service personnel help our property owners and managers use our websites to list their properties, answer their questions, and perform listing reviews and other processes as a part of our efforts to ensure quality, trust and security. Our customer service personnel also help travelers use our websites to book their travel and answer their questions. Our merchant fees are based on a contractual rate per transaction and will increase in absolute dollars as sales of listings increase, but for 2013 we expect our merchant fees to remain relatively constant and commensurate with 2012 levels, as a percentage of revenue. In general, as we add more features and functionality to our websites and anticipate an increase in the number of travelers accessing our websites, we will increase our spending on hardware and software required for hosting. We expect these additional costs to cause our cost of revenue to increase both in absolute dollars and slightly as a percentage of revenue in 2013 as compared to 2012.

We view the operation of our websites as a foundation upon which different revenue streams are generated. Cost of revenue, as described above, which includes the cost of customer service personnel, web hosting and merchant fees, directly supports our listing revenue, which was 16.7% and 16.4% of total revenue in the three months ended March 31, 2013 and 2012, respectively. These same expenses support the overall operation of our websites and therefore our other revenue. There are no other material distinct costs of revenue for any period presented. The reporting of cost of revenue as one category in our consolidated financial statements is consistent with the manner in which we manage our business.

Product Development. Product development expenses consist primarily of personnel costs, third-party contracting and consulting fees associated with our research and development of new services, expenses associated with improvements to, and maintenance of, existing services, and depreciation. We have historically focused our product development efforts on increasing the functionality and enhancing the ease of use of our websites, both for property owners and managers and for travelers. We intend to increase our technology and product resources by hiring additional personnel in future periods as we anticipate an increase in the number of listings and develop new features and products. We expect these additional investments to cause our product development expenses to increase both in absolute dollars and as a percentage of revenue in 2013 as compared to 2012.

Sales and Marketing. Sales and marketing expenses consist primarily of amounts paid for pay-per-click, or PPC, online display advertising, broad reach advertising, personnel costs for our marketing, search engine optimization, or SEO, sales staff, and consulting and other services firms fees, expenses associated with email marketing programs, and public relations expenses and depreciation. We utilize PPC advertising primarily to increase the number of travelers to our websites who are seeking properties in specific geographical areas in order to increase the number of inquiries regarding vacation rentals. Our sales and marketing team also focuses on increasing the placement of our websites in search rankings on Google, Bing and other search engines, which results in owner, manager and traveler acquisition at relatively little incremental expense. We intend to significantly increase our sales expense to drive additional listing sales to professional property managers and increase marketing efforts to support our new products, increase the traffic to our websites and increase overall brand awareness. We expect our sales and marketing expenses to increase in absolute dollars, but decline as a percentage of revenue in 2013 as compared to 2012.

General and Administrative. General and administrative expenses consist of personnel costs for our executive, finance and accounting, and management information systems personnel, professional fees for legal, audit, and other consulting services, allocated facility expenses, depreciation and other corporate overhead expenses. We expect to increase headcount to support our anticipated growth, which will result in an increase in other expenses, such as facilities, office and travel. We also expect to continue to incur costs associated with operating as a public company, including increases in our finance, accounting and legal personnel, additional consulting, legal and audit fees, insurance costs, board of directors compensation, and costs associated with compliance with the Sarbanes-Oxley Act and other requirements. As a result, we expect our general and administrative expenses to increase in absolute dollars but remain flat or decline slightly as a percentage of revenue in 2013 as compared to 2012.

Depreciation

Property and equipment, office tenant improvements and software licenses are recorded at cost and are depreciated using the straight-line method over their estimated useful lives. Equipment and computer hardware are depreciated over three years and furniture and fixtures over five to ten years. Leasehold improvements are recorded at cost and depreciated over the shorter of the contractual lease period or their useful life. We allocate depreciation to expense categories based on the relative number of employees in each category. Based on our current estimated level of capital expenditures, we expect our depreciation expense to increase in absolute dollars but to remain relatively stable as a percentage of revenue in 2013 as compared to 2012.

Amortization

Due to our historical acquisitions, we have recorded identifiable intangible assets, which are being amortized over their estimated useful lives. As a result, our amortization expense has grown as we have made acquisitions. We perform annual impairment testing of goodwill and indefinite-lived intangible assets, or whenever events or circumstances indicate that impairment may have occurred. Due to our website network and brand consolidation efforts, we began amortizing certain indefinite-lived intangible assets in the second quarter of 2012, which previously had not been amortized. This change in estimate, along with amortization from the impact of our acquisition of Top Rural S.L., or Toprural, in April 2012, will result in increased amortization expense, offset by decreases as certain intangible assets become fully amortized. We expect our amortization expenses to decrease in absolute dollars in 2013 as compared to 2012, as well as decrease as a percentage of revenue in 2013. Amortization expense will depend on our future acquisition activity.

Other Income (Expense)

Interest expense is offset by interest earned on our excess cash, which is invested in short-term instruments. At March 31, 2013, we had operations in the United States, the United Kingdom, Germany, France, Spain, Brazil, Australia and Switzerland. As a result of operating in multiple countries, we incur gains and losses on foreign currency transactions, primarily related to the valuation of intercompany loans and short-term advances.

Income Taxes

We accrue federal, state, and foreign income taxes at the applicable statutory rates adjusted for certain items, including non-deductible expenses, the most significant of which is stock-based compensation, and changes in our reserves for uncertain tax positions and deferred tax asset valuation allowance.

Significant judgment is required in evaluating any uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate due to additional information. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which the determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as any related net interest and penalties.

Significant judgment is also required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income, reversals of existing taxable temporary differences and the feasibility of tax planning. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which the determination is made.

Historically, we have generated most of our current taxable income outside of the United States due to net operating loss carryforwards available for utilization in the United States. However, in 2013 we expect to utilize most of our available U.S. NOL carryforward. In the remainder of 2013, we expect to pay corporate income taxes associated with our operations in the United

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Kingdom, France, Germany, Spain, Brazil and Colombia, as well as certain states within the United States. We will continue to expand our business outside of the United States, in which case, we will become subject to further taxation based on foreign statutory tax rates in those jurisdictions where we operate, and our effective tax rate may fluctuate as a result.

During the second quarter of 2011, we began implementing a global corporate restructuring plan involving our European headquarters in Geneva, Switzerland to integrate our acquired businesses, streamline our European operations, and improve our internal controls. Our Swiss and U.S. subsidiaries also entered into an agreement to share the costs of website development going forward. The impact of this restructuring plan and the start-up period in Switzerland results in volatility in our provision for income taxes and our effective tax rate.

Critical Accounting Policies and Estimates

Our consolidated financial statements include the accounts of our U.S.-based operations and our U.K., France, Germany, Brazil, Netherlands, Spain, Australia and Switzerland-based subsidiaries. Our consolidated results are prepared in accordance with U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. To the extent there are material differences between these estimates and our actual results, our consolidated financial statements will be affected.

Our significant accounting policies are described in Note 2 to the accompanying condensed consolidated financial statements included, and, of those policies, we believe that the accounting policies listed below involve the greatest degree of complexity and exercise of judgment by our management. The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results of operations particularly in the areas of business combination and taxes. Accordingly, we believe the policies listed below are the most critical for understanding and evaluating our financial condition and results of operations. These critical accounting policies are:

- Revenue recognition;
- Business combinations;
- Stock-based compensation; and
- Income taxes.

A description of our critical accounting policies that involve significant management judgments appears in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2013 under Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

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Results of Operations

The following table presents our operating results and our operating results as a percentage of revenue for the periods indicated:

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
	(in thousands, except per share data)	
Consolidated Statements of Operations Data:		
Revenue:		
Listing	$ 66,831	$ 53,968
Other	12,633	10,135
Total revenue	79,464	64,103
Costs and expenses:		
Cost of revenue (exclusive of amortization shown separately below)	13,281	10,532
Product development	12,399	9,702
Sales and marketing	26,367	24,734
General and administrative	16,049	12,837
Amortization expense	3,180	2,448
Total costs and expenses	71,276	60,253
Operating income	8,188	3,850
Other income (expense):		
Interest income	243	169
Other income (expense)	(1,591)	(728)
Total other income (expense)	(1,348)	(559)
Income before income taxes	6,840	3,291
Income tax expense	(1,545)	(890)
Net income	$ 5,295	$ 2,401
Net income per share:		
Basic and diluted	$ 0.06	$ 0.03
Weighted average number of shares outstanding		
Basic	83,940	81,353
Diluted	86,492	84,500

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	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Consolidated Statements of Operations as a Percentage of Revenue:		
Revenue:		
Listing	84.1%	84.2%
Other	15.9	15.8
Total revenue	100.0	100.0
Costs and expenses:		
Cost of revenue (exclusive of amortization shown separately below)	16.7	16.4
Product development	15.6	15.1
Sales and marketing	33.2	38.6
General and administrative	20.2	20.0
Amortization expense	4.0	3.8
Total costs and expenses	89.7	94.0
Operating income	10.3	6.0
Other income (expense):		
Interest income	0.3	0.3
Other income (expense)	(2.0)	(1.1)
Total other income (expense)	(1.7)	(0.9)
Income before income taxes	8.6	5.1
Income tax expense	(1.9)	(1.4)
Net income	6.7%	3.7%

Comparison of the Three Months Ended March 31, 2013 and 2012

Revenue

	Three Months Ended March 31,					
	2013		2012		Change	
Revenue	**Amount**	**Percentage of Revenue**	**Amount**	**Percentage of Revenue**	**Amount**	**Percent**
	(dollars in thousands)					
Listing	$ 66,831	84.1%	$ 53,968	84.2%	$ 12,863	23.8%
Other	12,633	15.9	10,135	15.8	2,498	24.6
Total	$ 79,464	100.0%	$ 64,103	100.0%	$ 15,361	24.0%

	Three Months Ended March 31,					
	2013		2012		Change	
Revenue	**Amount**	**Percentage of Revenue**	**Amount**	**Percentage of Revenue**	**Amount**	**Percent**
	(dollars in thousands)					
United States	$ 49,564	62.4%	$ 40,166	62.7%	$ 9,398	23.4%
International	29,900	37.6	23,937	37.3	5,963	24.9

Total	$ 79,464	100.0%	$ 64,103	100.0%	$ 15,361	24.0%

Revenue was $79.5 million in the three months ended March 31, 2013, compared to $64.1 million in the three months ended March 31, 2012, an increase of $15.4 million, or 24.0%. Our U.S. revenue was $49.6 million, or 62.4% of our total revenue, during the first quarter of 2013, compared to $40.2 million, or 62.7% of our total revenue, in the same quarter during 2012.

While our overall revenue growth rate for the three months ended March 31, 2013 was 24.0%, our organic revenue growth rate was 21.7%, mainly due to the acquisition of Toprural in April 2012 that was not included in our organic revenue growth rate. We consider growth to be organic if generated from businesses that we have owned for at least 12 months.

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Listing Revenue

Our core listing business revenue increased by $12.9 million, or 23.8%, in the three months ended March 31, 2013 as compared to the three months ended March 31, 2012, primarily due to an increased number of new listings and an increase in revenue per listing. Paid listings increased from 699,088 at March 31, 2012 to 742,299 at March 31, 2013, an increase of 6.2%. Paid listings increased as more owners became aware of our marketplace and as we increased our efforts to increase listings from professional property managers. In addition, we added approximately 12,000 listings in Spain as part of our purchase of Toprural. Our average revenue per listing was $368 in the three months ended March 31, 2013 compared to $322 in the three months ended March 31, 2012, an increase of $46, or 14.3%. The increase was due to base price increases made for certain brands as well as the introduction of tiered pricing on five of our websites, offset by a reduction in average revenue per listing as a result of lower average revenue per listing of our Australian listings.

Other Revenue

Other revenue increased by $2.5 million, or 24.6%, in the three months ended March 31, 2013 compared to the three months ended March 31, 2012. Revenue from products focused on travelers, such as property damage protection and trip insurance and the Carefree Rental Guarantee, generated increased revenue of $1.3 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012. Revenue from our owner reservation tool and the related merchant bank credit card royalties increased by $522,000 in the three months ended March 31, 2013 compared to the three months ended March 31, 2012.

Revenue Growth in Constant Currency

We invoice and collect payments in the Euro, the British Pound, the Brazilian Reis and the Australian Dollar in their respective regions. As a result, our total revenue is affected by changes in the value of the U.S. Dollar relative to these other currencies. In order to provide a comparable framework for assessing how our business performed excluding the effect of foreign currency fluctuations, management analyzes year-over-year revenue growth on a constant currency basis. Since we operate with the U.S. Dollar as our functional currency, we calculate constant currency on revenue recognized during the current period that was originally booked in currencies other than the U.S. Dollar by comparing the exchange rates used to recognize revenue in the current period against the exchange rates used to recognize revenue in the comparable prior period.

In the three months ended March 31, 2013, the year-over-year growth in listing revenue measured on a constant currency basis was 24.1%, compared with 23.8% as reported. The year-over-year growth in total revenue in the three months ended March 31, 2013 measured on a constant currency basis was 24.2%, compared with 24.0% as reported.

Cost of Revenue

	Three Months Ended March 31,				Change	
	2013		2012			
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percent
	(dollars in thousands)					
Cost of revenue	$ 13,281	16.7%	$ 10,532	16.4%	$ 2,749	26.1%

Cost of revenue was $13.3 million in the three months ended March 31, 2013, compared to $10.5 million in the three months ended March 31, 2012, an increase of $2.7 million, or 26.1%. A large part of the increase was due to a $1.9 million increase in salaries, benefits, bonuses and related expenses, including non-cash stock-based compensation, for our customer service and web-hosting personnel. At March 31, 2013, we had 88 additional customer support personnel and six additional personnel to support our web-hosting operations compared to the number of our customer service and web-hosting personnel at March 31, 2012. With increased customer service employees as well as increased investment in hosting equipment, we incurred a higher expense for depreciation of computer equipment, furniture and facility leasehold improvements, which increased $375,000, or 23.9%, for the three months ended March 31, 2013 compared to the three months ended March 31, 2012. Other increases included $499,000 in increases in software licenses and maintenance for our corporate systems.

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Product Development

	Three Months Ended March 31, 2013 Amount	2013 Percentage of Revenue	2012 Amount	2012 Percentage of Revenue	Change Amount	Change Percent
	(dollars in thousands)					
Product development	$ 12,399	15.6%	$ 9,702	15.1%	$ 2,697	27.8%
Capitalized software development costs	2,024	2.5	1,259	2.0	765	60.8
Total product and technology costs expensed and capitalized	$ 14,423	18.2%	$ 10,961	17.1%	$ 3,462	31.6%

Product development expense was $12.4 million in the three months ended March 31, 2013, compared to $9.7 million in the three months ended March 31, 2012, an increase of $2.7 million, or 27.8%. A large part of the increase was due to a $3.3 million increase in salaries, benefits, bonuses and related expenses, including non-cash stock-based compensation, offset by an increase in capitalized software costs of $765,000. At March 31, 2013, we had 74 additional employees in product development compared to March 31, 2012. Overall increases in headcount also drove higher facilities and depreciation expense of $247,000 in the three months ended March 31, 2013.

Sales and Marketing

	Three Months Ended March 31, 2013 Amount	2013 Percentage of Revenue	2012 Amount	2012 Percentage of Revenue	Change Amount	Change Percent
	(dollars in thousands)					
Sales and marketing	$ 26,367	33.2%	$ 24,734	38.6%	$ 1,633	6.6%

Sales and marketing expense was $26.4 million in the three months ended March 31, 2013, compared to $24.7 million in the three months ended March 31, 2012, an increase of $1.6 million, or 6.6%. Salaries, benefits, bonuses and related expenses, including non-cash stock-based compensation, increased $2.5 million due primarily to an increase in the number of our employees. At March 31, 2013, we had 91 additional employees in sales and marketing compared to March 31, 2012. Overall increases in headcount also drove higher facilities and depreciation expense of $325,000. Other increases included $471,000 from contracting and travel expenses. In addition, direct marketing expenses decreased by $1.6 million due to the shift from television advertising to pay-per-click and online display advertising.

General and Administrative

	Three Months Ended March 31, 2013 Amount	2013 Percentage of Revenue	2012 Amount	2012 Percentage of Revenue	Change Amount	Change Percent
	(dollars in thousands)					
General and administrative	$ 16,049	20.2%	$ 12,837	20.0%	$ 3,212	25.0%

General and administrative expense was $16.0 million in the three months ended March 31, 2013, compared to $12.8 million in the three months ended March 31, 2012, an increase of $3.2 million, or 25.0%. A large part of the increase was due to a $2.1 million increase in salaries, benefits, bonuses and related expenses, including non-cash stock-based compensation. At March 31, 2013, we had 39 additional employees and executives in operations, finance, human resources, legal and various information technology areas compared to the number of operations, finance, human resources, legal and various IT personnel at March 31, 2012. Other increases included $397,000 of expense related to estimated claims under the Basic Rental Guarantee offered to travelers and $531,000 in equipment expense.

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Amortization

	Three Months Ended March 31,					
	2013		2012		Change	
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percent
	(dollars in thousands)					
Amortization expense	$ 3,180	4.0%	$ 2,448	3.8%	$ 732	29.9%

Amortization expense was $3.2 million in the three months ended March 31, 2013, compared to $2.4 million in the three months ended March 31, 2012, an increase of $732,000, or 29.9%. Increases in amortization expense in the three months ended March 31, 2013 compared to the three months ended March 31, 2012 included $576,000 as a result of amortizing certain previously indefinite-lived intangible assets and $390,000 due to the addition of identifiable intangible assets from our acquisition of Toprural in 2012. These increases were partially offset by a decrease of $327,000 in our amortization expense resulting from certain intangible assets from prior acquisitions becoming fully amortized.

Other Income (Expense)

	Three Months Ended March 31,					
	2013		2012		Change	
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percent
	(dollars in thousands)					
Other income (expense)	$ (1,348)	(1.7)%	$ (559)	(0.9)%	$ (789)	141.1%

Other income (expense) includes approximately $1.5 million in losses from foreign currency related transactions in the three months ended March 31, 2013, compared to losses of $751,000 in the three months ended March 31, 2012. These losses consist primarily of the re-measurement of intercompany loans and other assets and liabilities denominated in foreign currencies, including gains/losses recognized on forward contracts. These losses were partially offset by interest income of $243,000 in the three months ended March 31, 2013, compared to $169,000 in in the three months ended March 31, 2012.

Income Taxes

	Three Months Ended March 31,					
	2013		2012		Change	
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percent
	(dollars in thousands)					
Income tax expense	$ 1,545	1.9%	$ 890	1.4%	$ 655	73.6%

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Our income tax expense was $1.5 million for the three months ended March 31, 2013, compared to $0.9 million for the three months ended March 31, 2012. The expense in the three months ended March 31, 2013 is primarily due to tax expense of $3.3 million determined using our estimated annual effective tax rate of 47.6% offset by certain items booked discretely in the three months ended March 31, 2013, including a benefit of $1.3 million due to disqualifying dispositions of incentive stock options, a benefit of $0.6 million related to the retroactive extension of the federal research and experimentation tax credit to January 1, 2012 and $0.5 million of expense related to a prior period that was deferred and recognized in the current period. The estimated annual effective tax rate at March 31, 2013 differed from the statutory rate primarily due to the benefit of disqualifying dispositions of incentive stock options, which is partially offset by non-deductible stock compensation charges, state taxes, the effect of different statutory tax rates in foreign jurisdictions and the federal research and experimentation tax credit.

The expense in the three months ended March 31, 2012 is primarily due to tax expense of $1.8 million determined using our estimated annual effective tax rate of 55.2% offset by a benefit of $0.9 million due to a disqualifying dispositions of incentive stock options booked discretely in the three months ended March 31, 2012. The estimated annual effective tax rate at March 31, 2012 differed from the statutory rate primarily due to non-deductible stock-based compensation charges, state taxes and the effect of different statutory tax rates in foreign jurisdictions.

The federal research and experimentation tax credit was extended on January 2, 2013 by the signing of the American Taxpayer Relief Act of 2012, or the Act . The Act retroactively extended this tax credit from January 1, 2012 through December 31, 2013. Because the Act was enacted during 2013, an income tax benefit of $0.6 million related to the 2012 research and experimentation tax credit is reflected as a discrete item in our results of operations for the quarter ended March 31, 2013.

Seasonality and Quarterly Results

Our operating results may fluctuate for a variety of reasons, including seasonal factors and economic cycles that influence the vacation travel market. Property owners and managers tend to buy listings at times when travelers are most likely to make vacation plans. The timing primarily depends on whether travelers are taking a winter or summer vacation and tends to vary by country. Historically, we have experienced the highest level of new and renewed listings in the first quarter of the year, which is typically when travelers are making plans for summer vacations in the United States and Europe. The lowest level of new listings and renewals has occurred in the third quarter. By the fourth quarter, we typically see property owners and managers of winter vacation destinations list and renew in time to meet the needs of travelers planning those trips. Other vacation areas outside of the United States and Europe, such as Brazil and Australia, also have seasonality, but the seasonality may not be reflected in the same quarters.

This cyclicality may not be seen as prominently in our revenue due to the ratable recognition of listing revenue. However, the seasonality results in higher cash flows during the first quarter as most listings are annual and fully paid at the time the listing is purchased. As we introduce new products for property owners, managers and travelers, the seasonality of those transactions may vary from the seasonality of our listing sales. We also experience seasonality in the number of visitors to our websites, also with the first quarter having the highest number of visitors. This is reflected in our quarterly financial results when we add customer service staff and hosting capabilities to support the increase.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful and historical results may not be indicative of future performance.

Discussion Regarding Adjusted EBITDA, Free Cash Flow and Pro Forma Net Income and Reconciliation to GAAP

We define Adjusted EBITDA as net income (loss) plus depreciation, amortization of intangible assets; interest expense, net; income tax expense (benefit); stock-based compensation expense, all net of any foreign exchange income or expense.

The following table presents a reconciliation of net income to Adjusted EBITDA (in thousands):

	Three Months Ended March 31,	
	2013	2012
Net income	$ 5,295	$ 2,401
Add:		
Depreciation and amortization	6,224	4,903
Stock-based compensation	7,456	5,198
Interest income	(243)	(169)

Foreign exchange expense	1,535	751
Income tax expense	1,545	890
Adjusted EBITDA	$ 21,812	$ 13,974

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We define free cash flow as our cash provided by operating activities, adjusted for cash interest expense and excess tax benefit (shortfall) from stock-based compensation, and subtracting capital expenditures. For the purpose of calculating free cash flow, we consider purchases of property, equipment, tenant improvements for our offices, and software licenses, including costs associated with internally developed software, as capital expenditures.

The following table presents a summary of cash flows and a reconciliation of cash flows from operating activities to free cash flows (in thousands):

	Three Months Ended March 31,	
	2013	**2012**
Cash provided by operating activities	$ 37,481	$ 33,360
Excess tax benefit from stock-based compensation	1,358	603
Capital expenditures	(5,505)	(5,809)
Free cash flow	$ 33,334	$ 28,154

We define pro forma net income as our net income (loss) plus the after-tax effect of stock-based compensation expense and amortization of intangible assets, utilizing an effective tax rate of 35%. The income tax effect of adjustments to pro forma net income assists investors in understanding the tax provision related to those adjustments and the effective tax rate of 35% related to ongoing operations.

The following table presents a reconciliation of net income to pro forma net income (in thousands):

	Three Months Ended March 31,	
	2013	**2012**
Net income	$ 5,295	$ 2,401
Add:		
Stock-based compensation	7,456	5,198
Amortization expense	3,180	2,448
Related tax effect	(3,723)	(2,676)
Pro forma net income	$ 12,208	$ 7,371

Adjusted EBITDA, free cash flow and pro forma net income are financial measures that are not calculated in accordance with accounting principles generally accepted in the United States, or GAAP. However, we believe that the use of Adjusted EBITDA, free cash flow and pro forma net income are useful to investors in evaluating our operating performance for the following reasons:

- our management uses Adjusted EBITDA, free cash flow and pro forma net income in conjunction with GAAP financial measures as part of our assessment of our business and in communications with our board of directors concerning our financial performance;

- Adjusted EBITDA, free cash flow and pro forma net income provide consistency and comparability with our past financial performance, facilitate period-to-period comparisons of operations, and also facilitate comparisons with other peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results;

- securities analysts use Adjusted EBITDA, free cash flow and pro forma net income as supplemental measures to evaluate the overall operating performance of companies; and

Adjusted EBITDA and pro forma net income exclude non-cash charges, such as depreciation, amortization and stock-based compensation, because such non-cash expenses in any specific period may not directly correlate to the underlying performance of our business operations and can vary significantly between periods.

Adjusted EBITDA, free cash flow and pro forma net income should not be reviewed in isolation. You should consider them in addition to, and not as substitutes for, measures of our financial performance reported in accordance with GAAP. Our Adjusted EBITDA, free cash flow or pro forma net income may not be comparable to similarly titled measures of other companies and because other companies may not calculate such measures in the same manner as we do. Adjusted EBITDA, free cash flow and pro forma net income have limitations as analytical tools. As an example, although depreciation and amortization are non-cash charges, the assets being depreciated or amortized will often need to be replaced in the future, and Adjusted EBITDA, free cash flow and pro forma net income do not reflect any cash requirements for these replacements. In addition, none of these measures reflect future requirements for contractual obligations.

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Further limitations of Adjusted EBITDA include:

- this measure does not reflect changes in working capital;
- this measure does not reflect interest income or interest expense; and
- this measure does not reflect cash requirements for income taxes.

Supplemental Financial Information

The following tables present stock-based compensation and depreciation included in the respective line items in our Consolidated Statements of Operations (in thousands):

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Stock-based compensation:		
Cost of revenue	$ 845	$ 416
Product development	1,727	1,231
Sales and marketing	1,608	1,270
General and administrative	3,276	2,281
Total	$ 7,456	$ 5,198

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Depreciation:		
Cost of revenue	$ 1,023	$ 819
Product development	684	549
Sales and marketing	944	766
General and administrative	393	321