

# TRAVELZOO INC

## FORM 10-Q (Quarterly Report)

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Sector	Technology
Fiscal Year	12/31

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

**Form 10-Q**

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

For the quarterly period ended June 30, 2005

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No.: 000-50171

**TRAVELZOO INC.**

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

**DELAWARE**

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

**590 Madison Avenue, 21st Floor,  
New York, New York**

*(Address of principal executive offices)*

**36-4415727**

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

**10022**

*(Zip Code)*

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of August 12, 2005, the registrant had outstanding 16,250,479 shares of its \$0.01 par value common stock.

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**TRAVELZOO INC.**

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**PART I—FINANCIAL INFORMATION**

**Item 1. Unaudited Condensed Consolidated Financial Statements**

**TRAVELZOO INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)**

	<u>June 30, 2005</u>	<u>December 31, 2004</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$21,684,711	\$26,434,989
Short term investments	19,840,000	10,031,738
Accounts receivable, less allowance for doubtful accounts of \$121,729 and \$127,547 as of June 30, 2005 and December 31, 2004, respectively	7,116,691	5,327,279
Deposits	149,457	163,130
Prepaid expenses and other current assets	354,527	674,208
Deferred income taxes	370,559	390,895
Total current assets	<u>49,515,945</u>	<u>43,022,239</u>
Deposits, less current portion	58,682	—
Deferred income taxes	43,237	43,237
Property and equipment, net	152,369	108,399
Intangible assets, net	50,544	83,563
Total assets	<u>\$49,820,776</u>	<u>\$43,257,438</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,428,327	\$ 439,425
Accrued expenses	2,888,621	2,464,269
Deferred revenue	286,336	91,137
Income tax payable	638,172	—
Total liabilities	<u>5,241,456</u>	<u>2,994,831</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock	162,505	162,332
Accumulated other comprehensive income	(586)	—
Additional paid-in capital	30,606,705	30,299,991
Retained earnings	<u>13,810,696</u>	<u>9,800,284</u>
Total stockholders' equity	<u>44,579,320</u>	<u>40,262,607</u>
Total liabilities and stockholders' equity	<u>\$49,820,776</u>	<u>\$43,257,438</u>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Revenues	\$12,258,139	\$ 7,201,189	\$23,486,559	\$13,663,422
Cost of revenues	224,314	166,092	403,592	345,435
Gross profit	<u>12,033,825</u>	<u>7,035,097</u>	<u>23,082,967</u>	<u>13,317,987</u>
Operating expenses:				
Sales and marketing	6,151,851	3,666,566	11,181,570	7,123,875
General and administrative	2,127,314	1,101,116	4,735,321	2,216,102
Total operating expenses	<u>8,279,165</u>	<u>4,767,682</u>	<u>15,916,891</u>	<u>9,339,977</u>
Income from operations	3,754,659	2,267,415	7,166,075	3,978,010
Other income and expense:				
Interest income	217,879	6,296	377,733	11,778
Foreign currency gain (loss)	<u>(4,121)</u>	<u>—</u>	<u>(4,121)</u>	<u>—</u>
Income before income taxes	3,968,417	2,273,711	7,539,687	3,989,788
Income taxes	<u>1,790,424</u>	<u>939,821</u>	<u>3,529,275</u>	<u>1,646,792</u>
Net income	<u>\$ 2,177,993</u>	<u>\$ 1,333,890</u>	<u>\$ 4,010,412</u>	<u>\$ 2,342,996</u>
Basic net income per share	\$ 0.13	\$ 0.08	\$ 0.25	\$ 0.13
Diluted net income per share	\$ 0.12	\$ 0.08	\$ 0.22	\$ 0.12
Shares used in computing basic net income per share	16,250,479	16,479,397	16,247,600	17,952,272
Shares used in computing diluted net income per share	17,852,493	17,762,745	17,998,217	19,205,543

See accompanying notes to unaudited condensed consolidated financial statements.

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

	<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 4,010,412	\$ 2,342,996
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	84,019	80,022
Deferred income taxes	20,336	—
Provision for losses on accounts receivable	46,982	82,902
Tax benefit of stock option exercises	396,067	943,110
Accrued interest income from short-term investments	(122,717)	—
Changes in operating assets and liabilities:		
Accounts receivable	(1,836,394)	(970,554)
Deposits	(45,009)	(13,707)
Prepaid expenses and other current assets	49,229	8,474
Accounts payable	988,902	277,513
Accrued expenses	694,805	514,332
Deferred revenue	195,199	167,488
Income tax payable	638,172	(2,065,023)
Net cash provided by (used in) operating activities	<u>5,120,003</u>	<u>1,367,553</u>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(94,970)	(26,357)
Purchase of short-term investments	(19,773,871)	—
Sale of short-term investments	10,088,326	—
Net cash used in investing activities	<u>(9,780,515)</u>	<u>(26,357)</u>
<b>Cash flows from financing activities:</b>		
Issuance costs incurred in connection with 2004 issuance of common stock	(123,730)	—
Proceeds from stock option exercises	34,550	295,769
Recovery of profit from purchase and sale of stock by employees	—	34,390
Net cash used in financing activities	<u>(89,180)</u>	<u>330,159</u>
Effect of exchange rate on cash and cash equivalents	(586)	—
Net increase (decrease) in cash and cash equivalents	(4,750,278)	1,671,355
Cash and cash equivalents at beginning of period	26,434,989	3,521,637
Cash and cash equivalents at end of period	<u>\$ 21,684,711</u>	<u>\$ 5,192,992</u>
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	<u>\$ 2,474,700</u>	<u>\$ 2,781,210</u>

See accompanying notes to unaudited condensed consolidated financial statements.

## TRAVELZOO INC.

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

#### (1) The Company and Basis of Presentation

Travelzoo Inc. (the “Company” or “Travelzoo”) is an Internet media company. The Company’s publications include the *Travelzoo* Web sites ([www.travelzoo.com](http://www.travelzoo.com) and [www.travelzoo.co.uk](http://www.travelzoo.co.uk)), the *Travelzoo Top 20* e-mail newsletters, and the *Newsflash* e-mail product. The Company also operates *SuperSearch*, a pay-per-click travel search engine.

Travelzoo is controlled by Ralph Bartel, who held approximately 78% of the outstanding shares as of August 1, 2005.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with Generally Accepted Accounting Principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company, and its results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and related notes as of and for the year ended December 31, 2004, included in the Company’s Form 10-K filed with the SEC on March 31, 2005.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005 or any other future period, and the Company makes no representations related thereto.

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

During January 2001, the Board of Directors of Travelzoo.com Corporation proposed that Travelzoo.com Corporation be merged with Travelzoo Inc. whereby Travelzoo Inc. would be the surviving entity. On March 15, 2002, the stockholders of Travelzoo.com Corporation approved the merger with Travelzoo Inc. On April 25, 2002, the certificate of merger was filed in Delaware upon which the merger became effective and Travelzoo.com Corporation ceased to exist. Each outstanding share of common stock of Travelzoo.com Corporation was converted into the right to receive one share of common stock of Travelzoo Inc. Under and subject to the terms of the merger agreement, stockholders were allowed a period of two years following the effective date of the merger to receive shares of Travelzoo Inc. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation, and no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect the reduction of the number of shares reported as outstanding. As of June 30, 2005, there were 16,250,479 shares of common stock outstanding

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company's being required to issue up to an additional approximately 4,082,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it will make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. The accompanying consolidated financial statements include a charge in general and administrative expenses of \$1,137,000 for these cash payments for the six months ended June 30, 2005 of which \$10,000 remains as a liability as of June 30, 2005. The liability is based on the number of actual requests received from former stockholders through June 30, 2005. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding an additional approximately 4,082,000 shares had not submitted claims under the program as of June 30, 2005.

The merger of Travelzoo.com Corporation into Travelzoo Inc. was accounted for as a combination of entities under common control using "as-if pooling-of-interests" accounting. Under this method of accounting, the assets and liabilities of Travelzoo.com Corporation and Travelzoo Inc. were carried forward at their historical costs. In addition, all prior period financial statements of Travelzoo Inc. were restated to include the combined results of operations, financial position and cash flows of Travelzoo.com Corporation. The restated results of operations and cash flows of Travelzoo Inc. are identical to the combined results of Travelzoo.com Corporation and Travelzoo Inc.

## **(2) Revenue Recognition**

All revenue consists of advertising sales. Advertising revenues are principally derived from the sale of advertising in the United States of America on the *Travelzoo* Web site, in the *Travelzoo Top 20* e-mail newsletter, in *Newsflash*, and in *SuperSearch*. Advertising revenues generated from the Company's operations in the United Kingdom were approximately \$9,000 during the three and six months ended June 30, 2005.

The Company recognizes revenues in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition*. Advertising revenues are recognized in the period in which the advertisement is displayed, provided that evidence of an arrangement exists, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. Where collectibility is not reasonably assured, the revenue will be recognized upon cash collection, provided that the other criteria for revenue recognition have been met. The Company recognizes revenue for fixed-fee advertising arrangements ratably over the term of the insertion order as described below. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate

performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed or clicks delivered during the period.

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

- *Evidence of an arrangement.* The Company considers an insertion order signed by the client or its agency to be evidence of an arrangement.
- *Delivery.* Delivery is considered to occur when the advertising has been displayed and, if applicable, the click-throughs have been delivered.
- *Fixed or determinable fee.* The Company considers the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.
- *Collection is deemed reasonably assured.* The Company conducts a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if it is expected that the client will be able to pay amounts under the arrangement as payments become due. If it is determined that collection is not reasonably assured, then revenue is deferred and recognized upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

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

Revenues from advertising sold to clients through agencies are reported at the net amount billed to the agency.

### **(3) Stock-based Compensation**

The Company did not provide any stock-based compensation in fiscal years 2003 and 2004 or in the six months ended June 30, 2005. In addition, all previously issued options vested prior to January 1, 2002 and therefore there are no applicable disclosures under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, as amended.

### **(4) Net Income Per Share**

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

The following table sets forth the calculation of basic and diluted net income per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
<b>Basic net income per share:</b>				
Net income	\$ 2,177,993	\$ 1,333,890	\$ 4,010,412	\$ 2,342,996
Weighted average common shares	16,250,479	16,479,397	16,247,600	17,952,272
Basic net income per share	\$ 0.13	\$ 0.08	\$ 0.25	\$ 0.13
<b>Diluted net income per share:</b>				
Net income	\$ 2,177,993	\$ 1,333,890	\$ 4,010,412	\$ 2,342,996
Weighted average common shares	16,250,479	16,479,397	16,247,600	17,952,272
Effect of dilutive securities: stock options	1,602,014	1,283,348	1,750,617	1,253,271
Diluted weighted average common shares	17,852,493	17,762,745	17,998,217	19,205,543
Diluted net income per share	\$ 0.12	\$ 0.08	\$ 0.22	\$ 0.12

## (5) Commitments and Contingencies

The Company leases office space in Chicago, London (United Kingdom), Miami, Mountain View (California), and New York. These operating leases expire on December 31, 2007, April 30, 2007, December 31, 2006, December 31, 2005 and December 31, 2005, respectively. The future minimum rental payments under these operating leases as of June 30, 2005, and December 31, 2004 total \$1,018,000 and \$1,082,000, respectively. The future lease payments consist of \$592,000 of payments due in 2005, \$272,000 of payments due in 2006, and \$154,000 of payments due in 2007.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company's being required to issue up to an additional approximately 4,082,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it will make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. The accompanying consolidated financial statements included a charge in general and administrative expenses of \$1,137,000 for these cash payments for the six months ended June 30, 2005 of which \$10,000 remains as a liability as of June 30, 2005. The liability is based on the number of actual requests received from former stockholders through the reporting date. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding approximately 4,082,000 shares had not submitted claims under the program.

## (6) Significant Customer Information and Segment Reporting

SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*, establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the way that management organizes the operating segments within a company for making operational decisions and assessing performance. As of June 30, 2005, the Company had two operating segments: North America and Europe. The Company began operations in the U.K. in May 2005. However, European operations were less than 5% of revenues, so detailed reporting is not required.

Significant customer information is as follows:

Customer	Percent of Revenues		Percent of Revenues		Percent of Accounts Receivable	
	Three Months Ended June 30,		Six Months Ended June 30,		June 30,	December 31,
	2005	2004	2005	2004	2005	2004
A	17%	*	17%	*	21%	10%
B	*	*	*	*	*	13%
C	10%	*	11%	*	12%	11%

All of the above customers are located in the United States of America.

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\* Less than 10%

## (7) Comprehensive Income

In accordance with SFAS 130, *Reporting Comprehensive Income*, the Company is required to display comprehensive income and loss and its components as part of the Company's consolidated financial statements. Accumulated other comprehensive income is comprised entirely of foreign currency translation adjustments recorded since the inception of Travelzoo UK Ltd in May 2005.

## (8) Recent Accounting Pronouncements

In March 2004, the Financial Accounting Standard Board's Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-01"). EITF 03-01 provides guidance on the meaning of "other-than-temporary" impairment and its application to certain marketable debt and equity securities accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and non-marketable securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. In September 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position EITF 03-01-1, which delays the effective date until additional guidance is issued for the application of the recognition and measurement provisions of EITF 03-01 to investments in securities that are impaired. However, the disclosure requirements were effective for annual periods ended after June 15, 2004 and have been adopted by the Company.

In December 2004, the Financial Accounting Standards Board issued SFAS 123R, *Share-Based Payments*, which requires the measurement of all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in the statement of operations. The accounting provisions of SFAS 123R are effective for fiscal years beginning after June 15, 2005. The Company will adopt SFAS 123R on January 1, 2006. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. As of June 30, 2005, the Company had no unvested stock-based compensation awards outstanding. If the Company makes share-based payments in the future, the adoption of SFAS No. 123R could have a significant adverse impact on the Company's consolidated statement of operations and net income per share.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations, assumptions, estimates and projections about Travelzoo and our industry. These forward-looking statements are subject to the many risks and uncertainties that exist in our operations and business environment that may cause actual results, performance or

achievements of Travelzoo to be different from those expected or anticipated in the forward-looking statements. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as “may”, “will”, “should”, “estimates”, “predicts”, “potential”, “continue”, “strategy”, “believes”, “anticipates”, “plans”, “expects”, “intends”, and similar expressions are intended to identify forward-looking statements. Travelzoo’s actual results and the timing of certain events could differ significantly from those anticipated in such forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed elsewhere in this Report in the section entitled “Risk Factors” and the risks discussed in our other Securities and Exchange Commission (“SEC”) filings. The forward-looking statements included in this report reflect the beliefs of our management on the date of this report. Travelzoo undertakes no obligation to update publicly any forward-looking statements.

## Overview

Travelzoo Inc. (the “Company” or “Travelzoo”) is an Internet media company that publishes travel offers from hundreds of travel companies. As the Internet is becoming consumers’ preferred medium to search for travel offers, we provide airlines, hotels, cruise lines, vacation packagers, and other travel companies with a fast, flexible, and cost-effective way to reach millions of users. While our products provide advertising opportunities for travel companies, they also provide Internet users with a free source of information on current sales and specials from hundreds of travel companies.

Our publications include the *Travelzoo* Web sites ([www.travelzoo.com](http://www.travelzoo.com) and [www.travelzoo.co.uk](http://www.travelzoo.co.uk)), the *Travelzoo Top 20* e-mail newsletters, and the *Newsflash* e-mail product. The Company also operates *SuperSearch*, a pay-per-click travel search engine. More than 300 travel companies purchase our advertising services.

Our revenues are advertising revenues, consisting of listing fees paid by travel companies to advertise their offers on the *Travelzoo* Web sites, in the *Travelzoo Top 20* e-mail newsletters, in the *Newsflash* e-mail product, and in *SuperSearch*, a pay-per-click travel search engine. Revenues are principally generated from the sale of advertising on our *Travelzoo* Web site and in our *Travelzoo Top 20* newsletter. Listing fees are based on placement, number of listings, number of impressions, or number of clickthroughs. Smaller advertising agreements — typically \$4,000 or less per month — typically renew automatically each month if they are not terminated by the client. Larger agreements are typically related to advertising campaigns and are not automatically renewed.

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

- Growth of number of subscribers of the Company’s newsletters and page views of selected sections of the *Travelzoo* Web sites;
- Growth in revenues in the absolute and relative to the growth in reach of the Company’s products;
- Operating margin;
- Revenue per employee as a measure of productivity.

## Critical Accounting Policies

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

## Revenue Recognition

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

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

- *Evidence of an arrangement.* We consider an insertion order signed by the client or its agency to be evidence of an arrangement.
- *Delivery.* Delivery is considered to occur when the advertising has been displayed and, if applicable, the clickthroughs have been delivered.
- *Fixed or determinable fee.* We consider the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.
- *Collection is reasonably assured.* We conduct a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if we expect that the client will be able to pay amounts under the arrangement as payments become due. If we determine that collection is not reasonably assured, then we defer the revenue and recognize the revenue upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

Advertising sold to clients through agencies is reported at the net amount billed to the agency.

## Allowance for Doubtful Accounts

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

## Liability to Former Stockholders

On October 15, 2004, we announced a program under which we will make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. We account for the cost of this program as an expense recorded in general and administrative expenses and a current accrued liability. The ultimate total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. We do not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid. We believe that only a portion of such requests were valid. In order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation.

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

## Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Revenues	100%	100%	100%	100%
Cost of revenues	<u>2</u>	<u>2</u>	<u>2</u>	<u>3</u>
Gross profit	<u>98</u>	<u>98</u>	<u>98</u>	<u>97</u>
Operating expenses:				
Sales and marketing	50	51	48	52
General and administrative	<u>17</u>	<u>15</u>	<u>20</u>	<u>16</u>
Total operating expenses.	<u>68</u>	<u>66</u>	<u>68</u>	<u>68</u>
Income from operations	31	32	31	29
Other income and expenses, net	<u>2</u>	<u>—</u>	<u>1</u>	<u>—</u>
Income before income taxes	32	32	32	29
Income taxes	<u>15</u>	<u>13</u>	<u>15</u>	<u>12</u>
Net income	<u>18%</u>	<u>19%</u>	<u>17%</u>	<u>17%</u>

For the six months ended June 30, 2005, we reported income from operations of approximately \$7.2 million. As of June 30, 2005, we had retained earnings of approximately \$13.8 million. Our operating margin increased to 30.5% of sales for the six months ended June 30, 2005 from 29.1% for the same period last year. The main reason for this increase in our operating margin is that our revenues grew faster than our sales and marketing expenses.

For the three months ended June 30, 2005, we reported income from operations of approximately \$3.8 million. Our operating margin decreased to 30.6% of sales for the three months ended June 30, 2005 from 31.5% for the same period last year. The main reason for this decrease in our operating margin is that our general and administrative expenses, including a loss from Travelzoo UK and expenses related to payments to former stockholders, grew faster than our revenues.

Although our operating margin increased in each of the last three years, we do not know if this trend will continue. Increased competition in our industry could force us to increase our marketing expenditures and could limit our ability to increase our advertising rates. Further, losses from our strategy to replicate our business model in selected foreign markets may have a material adverse impact on our results of operations.

The increase in other income from approximately \$6,000 in the three months ended June 30, 2004 to approximately \$218,000 in the three months ended June 30, 2005 represents interest earned on the Company's cash, cash equivalents, and short term investments.

Our loss from operations in the United Kingdom was approximately \$175,000 for the three and six months ended June 30, 2005.

## Reach

The following table sets forth the number of subscribers of each of our e-mail publications in both the U.S.A. and the U.K. as of June 30, 2005 and 2004 and the total number of page views for selected sections of the *Travelzoo* Web site in U.S.A. for the six months ended June 30, 2005 and 2004. Management considers the *Travelzoo* homepages and the front pages of destination categories as indicators for the growth of Web site traffic. Management reviews these non-financial metrics for two reasons: First, to monitor our progress in increasing the reach of our products. Second, to evaluate if we are able to convert higher reach into higher revenues.

	June 30,		Year-over-Year Growth
	2005	2004	
<b>Subscribers:</b>			
<i>Travelzoo Top 20</i>	8,411,000	7,084,000	19%
<i>Newsflash</i>	5,334,000	4,172,000	28%

	Six Months Ended June 30,		Year-over-Year Growth
	2005	2004	
<b>Page views of selected sections of <i>Travelzoo</i> Web site:</b>			
Homepage	20,800,000	14,830,000	40%
Front pages of destination categories	32,309,000	29,808,000	8%

Management believes that the increase in reach of its publications in the six months ended June 30, 2005 was in line with its strategy.

The Company's revenues for the six months ended June 30, 2005 increased by 72% from the same period last year. The number of subscribers of the *Travelzoo Top 20* e-mail newsletters increased by 19%. Page views of selected sections of the *Travelzoo* Web site increased by 40% and 8% as shown in the table above. In the six months ended June 30, 2004, 92% of revenues were generated from the *Travelzoo* Web sites and the *Travelzoo Top 20* newsletters. In the six months ended June 30, 2005, 65% of revenues were generated from the *Travelzoo* Web sites and the *Travelzoo Top 20* newsletters. Management believes that the data for the six months ended June 30, 2005 and 2004 indicate that the Company was able to generate higher revenues as reach increased.

### **Revenues**

Our total revenues increased to \$12.3 million for the three months ended June 30, 2005 from \$7.2 million for the three months ended June 30, 2004. Our total revenues increased to \$23.5 million for the six months ended June 30, 2005 from \$13.7 million for the six months ended June 30, 2004. This represents an increase of 72%.

Our revenues from operations in the U.K. for the three and six months ended June 30, 2005 were approximately \$9,000.

71% of our revenue growth in the six months ended June 30, 2005 compared to the six months ended June 30, 2004 came from our new product, *SuperSearch*. The remaining 29% came from our existing products (i.e. *Travelzoo* Web sites, *Travelzoo Top 20* newsletters, and *Newsflash*) and is attributed to an increase in our advertising rates for our existing products and an increase in the number of clients and the volume of advertising sold. Approximately 21% of the revenue growth in the six month period ended June 30, 2005 compared to the six months ended June 30, 2004 is attributed to an increase in our advertising rates for our existing products. Due to the increase in the reach of our publications, we increased the prices for advertising placements on average by approximately 15% as of January 1, 2005. Approximately 8% of our revenue growth in the period ended June 30, 2005 compared to the six months ended June 30, 2004 is attributed to an increase in the number of clients and an increase in the volume of advertising sold to existing clients.

In the six months ended June 30, 2005, two clients accounted for more than 10% of our total revenues. Click Here, Inc., an advertising agency representing Travelocity.com, accounted for 17% of our revenues. Orbitz, LLC accounted for 11% of our revenues. In the six months ended June 30, 2004, none of our clients accounted for more than 10% of our total revenues. The increase in our concentration of revenues is primarily the result of our new *SuperSearch* product. At this time, we sell *SuperSearch* listings primarily to the large online travel agencies like Orbitz and Travelocity.com. Management expects revenue concentration to remain at the current level in the foreseeable future.

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

- Our ability to increase our advertising rates;
- Our ability to sell more advertising to existing clients; and
- Our ability to increase the number of clients.

We believe that we can increase our advertising rates only if the reach of our publications increases. We do not know if we will be

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

Average annualized revenue per employee increased to \$817,000 for the three months ended June 30, 2005 from \$588,000 for the three months ended June 30, 2004.

### ***Cost of Revenues***

Cost of revenues consists of network expenses, including fees we pay for co-location services, depreciation of network equipment, salary expenses associated with network operations staff, and fees for photos used in our publications. Our cost of revenues increased to \$224,000 for the three months ended June 30, 2005 from \$166,000 for the three months ended June 30, 2004. Our cost of revenues increased to \$404,000 for the six months ended June 30, 2005 from \$345,000 for the six months ended June 30, 2004. As a percentage of revenue, cost of revenues decreased to 2%, for the six months ended June 30, 2005 from 3% for the six months ended June 30, 2004. The decrease was due to increase in revenues without a corresponding increase in cost of revenues.

### ***Operating Expenses***

#### ***Sales and Marketing***

Sales and marketing expenses consist primarily of advertising and promotional expenses, salary expenses associated with sales and marketing staff, conference expenses, and public relations expenses. Sales and marketing expenses increased to \$6.2 million for the three months ended June 30, 2005 from \$3.7 million for the three months ended June 30, 2004. Sales and marketing expenses increased to \$11.2 million for the six months ended June 30, 2005 from \$7.1 million for the six months ended June 30, 2004. The increase in sales and marketing expenses was primarily due to increases of our advertising campaigns. The goal of our advertising was to acquire new subscribers for our e-mail products and to increase brand awareness for *Travelzoo*. For the six months ended June 30, 2005 and 2004, advertising expenses accounted for 77% and 73%, respectively, of sales and marketing expenses. Advertising activities during these periods consisted primarily of online advertising. The increase in sales and marketing expenses in the six months ended June 30, 2005 compared to the six months ended June 30, 2004 was also due to an increase in headcount of our sales force.

Our goal is to increase our revenues from advertising sales. One important factor that drives our revenues is our advertising rates. We believe that we can increase our advertising rates only if the reach of our publications increases. In order to increase the reach of our publications, we have to acquire a significant number of new subscribers in every quarter and continue to promote our brand. Therefore, we expect our sales and marketing expenses related to our business in the United States of America as a percentage of revenue to remain at the current level or increase from the current level. The main factor that impacts our advertising expenses is the average cost per acquisition of a new subscriber. We believe that the average cost per acquisition depends mainly on the advertising rates which we pay for media buys, our ability to manage our subscriber acquisition efforts successfully, and the degree of competition in our industry.

In May 2005, we incorporated Travelzoo UK Ltd (“Travelzoo UK”) as a wholly-owned subsidiary and began hiring local staff in the United Kingdom. The start-up of our business in the United Kingdom is expected to result in a significant additional increase in our sales and marketing expenses in the foreseeable future.

#### ***General and Administrative***

General and administrative expenses consist primarily of compensation for administrative and executive staff, fees for professional services, rent, bad debt expense, amortization of intangible assets and general office expense. General and administrative expenses increased to \$2.1 million for the three months ended June 30, 2005 from \$1.1 million for the three months ended June 30, 2004. General and administrative expenses increased to \$4.7 million for the six months ended June 30, 2005 from \$2.2 million for the six months ended June 30, 2004. In 2005, general and administrative expenses increased primarily due to expenses of \$1.1 million for cash payments made or to be made to former stockholders of Travelzoo.com Corporation and also due to increases in expenses for legal and professional services related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

In the six months ended June 30, 2005, the Company recorded expenses of \$1.1 million related to a program under which the

Company intends to make cash payments to former stockholders of Travelzoo.com Corporation, who failed to submit requests for shares in Travelzoo Inc. within the required time period. The expenses are based on the number of actual valid claims received and the Company's stock price. The Company expects expenses related to the program to decrease in future periods.

We expect that we will incur significant expenses in 2005 in order to allow management to report on, and our independent auditors to attest to, our internal controls over financial reporting, as required by Section 404 for the Sarbanes-Oxley Act of 2002. At this time, the total cost is not reliably estimable as it will be dependent on the number of areas requiring improvement and on remediation efforts where necessary. The Company has expensed approximately \$317,000 in third-party compliance costs in the six months ended June 30, 2005. Currently, none of our identified areas that need improvement have been categorized as material weaknesses or significant deficiencies. However, we are still in the evaluation process, and we may identify conditions that may result in significant deficiencies or material weaknesses in the future.

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

We expect the operations of Travelzoo UK to result in a significant additional increase in our general and administrative expenses.

### **Subscriber Acquisition**

The table set forth below provides for each quarter in 2002, 2003, 2004, and the first two quarters of 2005, an analysis of our average cost for acquisition of new subscribers for our *Travelzoo Top 20* newsletters and our *Newsflash* e-mail alert service.

The table includes the following data:

- **Average Cost per Acquisition of a New Subscriber:** This is the quarterly costs of consumer marketing programs whose purpose was primarily to acquire new subscribers, divided by total new subscribers added during the quarter.
- **New Subscribers:** Total new subscribers who signed up for at least one of our e-mail publications throughout the quarter. This is an unduplicated subscriber number, meaning a subscriber who signed up for two or more of our publications is only counted once.
- **Unsubscribes:** Subscribers who were removed from our list throughout the quarter either as a result of their requesting removal, or based on periodic list maintenance after we determined that the e-mail address was likely no longer valid.
- **Balance:** This is the number of subscribers at the end of the quarter, computed by taking the previous quarter's subscriber balance, adding new subscribers during the current quarter, and subtracting unsubscribes during the current quarter.

<b>Period</b>	<b>Average Cost per Acquisition of a New Subscriber</b>	<b>New Subscribers</b>	<b>Unsubscribes</b>	<b>Balance</b>
Q1 2002	\$0.93	254,140	(24,547)	1,614,130
Q2 2002	\$0.95	590,266	(156,204)	2,048,192
Q3 2002	\$1.01	740,656	(51,566)	2,737,282
Q4 2002	\$1.31	799,958	(55,064)	3,482,176
Q1 2003	\$1.62	693,872	(213,423)	3,962,625
Q2 2003	\$1.58	924,902	(172,403)	4,715,124
Q3 2003	\$1.52	1,108,045	(248,964)	5,574,205
Q4 2003	\$2.17	869,286	(240,907)	6,202,584
Q1 2004	\$2.23	920,063	(185,151)	6,937,496
Q2 2004	\$2.58	858,899	(634,702)	7,161,693
Q3 2004	\$1.26	1,298,962	(602,628)	7,858,027
Q4 2004	\$1.70	694,026	(343,139)	8,145,737
Q1 2005	\$2.59	659,459	(475,938)	8,329,258
Q2 2005	\$2.62	806,734	(533,109)	8,602,883

We have noted a trend of increasing cost per new subscriber over the last few years, driven by a gradual increase in online advertising rates by our media suppliers as well as increased activity from competitors using similar forms of online advertising for their own marketing efforts. The decline in new subscriber acquisition costs in Q3 2004 and Q4 2004 reflects the effect of new advertising campaigns which were tested at that time. We do not consider the decline in new subscriber costs in Q3 2004 and Q4 2004 to be necessarily indicative of a longer-term trend that our subscriber costs are likely to stay at this level or are likely to decline further.

The operational impact of increased acquisition cost is higher absolute marketing expenses and potentially higher relative marketing expenses as a percentage of revenue. Going forward we expect continued upward pressure on online advertising rates and continued activity from competitors, which will likely increase our cost per new subscriber over the long term. The effect on operations is that greater absolute and relative marketing expenditure may be necessary to continue to grow the reach of our publications. It is possible that the factors driving subscriber acquisition cost increases can be partially or completely offset by new or improved methods of subscriber acquisition using techniques which are under evaluation. Thus we are not able to meaningfully predict the short-term quarterly trend in the cost of acquiring new subscribers.

### ***Income Taxes***

For the three months ended June 30, 2005, we recorded an income tax provision of \$1.8 million. For the three months ended June 30, 2004, we recorded an income tax provision of \$940,000. For the six months ended June 30, 2005, we recorded an income tax provision of \$3.5 million. For the six months ended June 30, 2004, we recorded an income tax provision of \$1.6 million. Our income is generally taxed in the U.S. and our income tax provisions reflect federal and state statutory rates applicable to our levels of income and expenses that are treated as having no recognizable tax benefit. For the six months ended June 30, 2005, our effective tax rate was 46.8%. Expenses of \$1.1 million related to a program under which the Company makes cash payments to former stockholders of Travelzoo.com Corporation, who failed to submit requests for shares in Travelzoo Inc. within the required time period, were treated as having no recognizable tax benefit. Further, a loss of \$175,000 from operations in the U.K. was treated as having no recognizable tax benefit.

We expect that our effective tax rate in future periods may fluctuate depending on changes in estimates in the total amount of expenses from payments to former stockholders and from losses or gains incurred by Travelzoo UK.

During the first quarter of 2005, the Company realized a tax benefit of \$396,000 upon the exercise of stock options by directors. The tax benefit reduced the Company's income tax payable and increased additional paid-in capital by this amount.

### ***Stockholders' Equity***

In January 2005, an aggregate of 17,275 shares of common stock were issued to a current director upon the exercise of fully vested options. The options were granted in 2001 and 2002 to the director for her services as director in 2000, 2001, and 2002.

### ***Liquidity and Capital Resources***

As of June 30, 2005, we had \$41.5 million in cash and cash equivalents and short-term investments. Cash and cash equivalents and short-term investments increased from \$36.5 million on December 31, 2004 primarily as a result of cash provided by operations as explained below. We expect that cash on hand and cash flows generated from operations will be sufficient to provide for working capital needs for at least the next 12 months.

Net cash provided by operating activities in the six months ended June 30, 2005 was \$5.1 million. Net cash provided by operating activities in the six months ended June 30, 2004 was \$1.4 million. In the six months ended June 30, 2005, net cash provided by operating activities resulted primarily from net income and an increase in accounts payable offset by an increase in accounts receivable. Accounts receivable as a percentage of revenue increased primarily because of a larger portion of insertion orders which include variable-fee advertising, particularly advertising in our *SuperSearch* product. If revenues from *SuperSearch* continue to increase as a percentage of revenues, we expect the increase of accounts receivable as a percentage of revenue to continue. In the six months ended June 30, 2004, net cash provided by operating activities resulted primarily from net income and an increase in accrued expenses offset by an increase in accounts receivable and a net decrease in income tax payable.

Net cash used in investing activities was \$9.8 million and \$26,000 during the six months ended June 30, 2005 and June 30, 2004, respectively. In the six months ended June 30, 2005, net cash used in investing activities were for the purchase of short-term investments and for equipment purchases. In the six months ended June 30, 2004, net cash was used in investing activities for equipment purchases.

Net cash used in financing activities was \$90,000 during the six months ended June 30, 2005. Net cash provided by financing activities was \$330,000 during the six months ended June 30, 2004. In the six months ended June 30, 2005, net cash used in financing activities resulted primarily from registration related expenses incurred during the period related to the issuance of common stock in October 2004. In the six months ended June 30, 2004, net cash provided by financing activities resulted primarily from proceeds from stock option exercises.

Our capital requirements depend on a number of factors, including market acceptance of our products and services, the amount of our resources we devote to development of our advertising products, cash payments to former stockholders of Travelzoo.com Corporation, expansion of our operations, and the amount of our resources we devote to promoting awareness of the *Travelzoo* brand. Since the inception of the cash payment program to former stockholders of Travelzoo.com Corporation, we have incurred expenses of \$2.3 million. While future payments for this program are expected to decrease, the total cost of this program is still undeterminable because it is dependent on our stock price and on the number of claims ultimately received. Consistent with our growth, we have experienced a substantial increase in our sales and marketing expenses since inception, and we anticipate that these increases will continue for the foreseeable future. We believe cash on hand and generated during those periods will be sufficient to pay such costs. In addition, we will continue to evaluate possible investments in businesses, products and technologies, the consummation of any of which would increase our capital requirements.

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

We expect that cash on hand will be sufficient to finance the operations of Travelzoo UK.

The following summarizes our principal contractual commitments as of June 30, 2005 (in thousands):

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Thereafter</u>	<u>Total</u>
Operating leases	\$592	272	154	—	—	\$1,018
Purchase obligations	<u>57</u>	<u>114</u>	<u>10</u>	—	—	<u>181</u>
Total commitments	\$649	386	164	—	—	\$1,199

As of June 30, 2005, we have recorded a liability of \$10,000 for the estimated minimum liability that is probable to be paid under a program to make cash payments to former stockholders of Travelzoo.com Corporation. The total liability incurred under this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received.

## RISK FACTORS

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

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

### ***Our limited operating history makes our business difficult to evaluate.***

We have only a limited operating history for you to consider in evaluating our business. As a young company, we face risks and uncertainties relating to our ability to successfully implement our business plan. You must consider the risks, expenses and uncertainties which can materially affect the business of a young company like ours. These risks include uncertainty whether we will be able to:

- increase awareness of the *Travelzoo* brand;
- attract and retain additional travel companies to list their special offers with us;
- attract additional Internet users to the *Travelzoo* Web sites ;
- attract additional Internet users as subscribers to our e-mail publications ;
- increase the functionality of our products and services;
- maintain our current, and develop new, business relationships;
- respond effectively to competitive pressures; and
- continue to develop and upgrade our technology.

### ***We cannot assure you that we will sustain profitability.***

Although we have been profitable in the past, there is no assurance that we will continue to be profitable. We forecast our future expense levels based on our operating plans and our estimates of future revenues. We may find it necessary to accelerate expenditures relating to our sales and marketing efforts or otherwise increase our financial commitment to creating and maintaining brand awareness among travel companies and Internet users. If our revenues grow at a slower rate than we anticipate, or if our spending levels exceed our expectations or cannot be adjusted to reflect slower revenue growth, we may not generate sufficient revenues to sustain profitability. If our new wholly-owned subsidiary in the United Kingdom, Travelzoo UK Ltd, incurs significant losses, this will result in a significant negative impact on our results of operations. In this case, the value of the shares of Travelzoo could be reduced.

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

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

- mismatches between resource allocation and client demand due to difficulties in predicting client demand in a new market;
- changes in general economic conditions that could affect marketing efforts generally and online marketing efforts in particular;
- the magnitude and timing of marketing initiatives;
- the introduction, development, timing, competitive pricing and market acceptance of our products and services and those of our competitors;
- our ability to attract and retain key personnel;
- our ability to manage our anticipated growth and expansion;
- our ability to attract traffic to our Web sites;
- technical difficulties or system downtime affecting the Internet generally or the operation of our products and services specifically; and
- payments which we make to previous stockholders of Travelzoo.com Corporation who failed to submit requests for shares in Travelzoo Inc. within the required time period.

In addition, we plan to significantly increase our operating expenses related to advertising campaigns for *Travelzoo* and the expansion of our sales and production departments. If revenues fall below our expectations in any quarter and we are unable to quickly reduce our spending in response, our operating results would be lower than expected and our stock price may fall.

***We depend on two clients for a substantial part of our revenues.***

Two of our current clients represent a substantial portion of our business. For the six months ended June 30, 2005, Click Here, Inc., an advertising agency representing Travelocity.com, accounted for 17% of our revenues and Orbitz, LLC accounted for 11% of our revenues. The loss of either client may result in a significant decrease in our revenues, which could have a material adverse effect on our business. We have written agreements with Click Here, Inc and Orbitz, LLC. The agreements provide that Travelzoo will be paid for the publication of ads on a cost-per-click basis. The Click Here, Inc. agreements are cancelable upon 90 days' written notice, and the payment terms are net 60 days with no discount for early payment. The Orbitz, LLC agreement is non-cancelable, and the payment terms are net 30 days with no discount for early payment. Copies of the agreements with Click Here and Orbitz were previously filed as exhibits to our Annual Report on Form 10-K for the year ended December 31, 2004 and to our Quarterly Report on Form 10-Q for the three months ended March 31, 2005.

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

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

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

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

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

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

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

The demand for online advertising may be linked to the level of economic activity and employment in the U.S. and abroad. Specifically, our business is dependent on the demand for online advertising from travel companies. The last recession decreased consumer travel and caused travel companies to reduce or postpone their marketing spending generally, and their online marketing spending in particular. If the current economic recovery does not continue, our business and financial condition could be materially adversely affected.

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

Our operations are susceptible to outages due to fire, floods, power loss, telecommunications failures, break-ins and similar events. In addition, a significant portion of our network infrastructure is located in Northern California, an area susceptible to earthquakes. We do not have multiple site capacity in the event of any such occurrence. Outages could cause significant interruptions of our service. In

addition, despite our implementation of network security measures, our servers are vulnerable to computer viruses, physical and electronic break-ins, and similar disruptions from unauthorized tampering with our computer systems. We do not carry business interruption insurance to compensate us for losses that may occur as a result of any of these events.

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

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

**Risks Related to Our Markets and Strategy**

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

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

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

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

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

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

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

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

- rapidly changing technology in online advertising;
- evolving industry standards, including both formal and *de facto* standards relating to online advertising;
- developments and changes relating to the Internet;
- competing products and services that offer increased functionality; and
- changes in travel company and Internet user requirements.

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

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

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

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

We have recently experienced a period of rapid growth. In order to execute our business plan, we must continue to grow significantly. As of June 30, 2005, we had 60 employees. We expect that the number of our employees will continue to increase for the foreseeable future. This growth has placed, and our anticipated future growth will continue to place, a significant strain on our management, systems and resources. We expect that we will need to continue to improve our financial and managerial controls and reporting systems and procedures. We will also need to continue to expand and maintain close coordination among our sales, production, marketing, IT, and finance departments. We may not succeed in these efforts. Our inability to expand our operations in an efficient manner could cause our expenses to grow disproportionately to revenues, our revenues to decline or grow more slowly than expected and otherwise have a material adverse effect on our business.

***Our international operations are subject to increased risks which could harm our business, operating results and financial condition.***

In May 2005, we began operations in the United Kingdom. In addition to uncertainty about our ability to generate net income from our foreign operations and expand our international market position, there are certain risks inherent in doing business internationally, including:

- trade barriers and changes in trade regulations;
- difficulties in developing, staffing and simultaneously managing foreign operations as a result of distance, language and cultural differences;
- stringent local labor laws and regulations;
- currency exchange rate fluctuations;
- risks related to government regulation; and
- potentially adverse tax consequences.

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

We compete with large Internet portal sites, such as America Online, Lycos, MSN and Yahoo!, that offer listings or other advertising opportunities for travel companies. These companies have significantly greater financial, technical, marketing and other resources and larger client bases. We also compete with search engines like Google and Overture that offer pay-per-click listings. In addition, we compete with newspapers, magazines and other traditional media companies that provide online advertising opportunities. We expect to face additional competition as other established and emerging companies, including print media companies, enter the online advertising market. Competition could result in reduced margins on our services, loss of market share or less use of *Travelzoo* by travel companies and consumers. If we are not able to compete effectively with current or future competitors as a result of these and other factors, our business could be materially adversely affected.

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

Our future success depends to a significant extent on the continued service and coordination of our management team, particularly Ralph Bartel, our Chairman, President, Chief Executive Officer, Chief Financial Officer and Secretary. The loss or departure of any of our officers or key employees could materially adversely affect our ability to implement our business plan. We do not maintain key person life insurance for any member of our management team. In addition, we expect new members to join our management team in

the future. These individuals will not previously have worked together and will be required to become integrated into our management team. If our key management personnel are not able to work together effectively or successfully, our business could be materially adversely affected.

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

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

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

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

The trading price of our common stock has been and may continue to be subject to wide fluctuations. During the first six months of 2005, the sale prices of our common stock on the NASDAQ National Market ranged from \$27.20 to \$99.75 per share. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions.

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

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

Ralph Bartel, who founded Travelzoo and who is our Chairman of the Board, President, Chief Executive Officer, Chief Financial Officer and Secretary, is our largest stockholder, holding approximately 78% of our outstanding shares with options to increase his percentage ownership to 81% on a fully-diluted basis. Through his share ownership, he is in a position to control Travelzoo and to elect our entire board of directors.

**Risks Related to Legal Uncertainty**

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

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

- user privacy;
- anti-spam legislation;
- consumer protection;
- copyright, trademark and patent infringement;
- pricing controls;

- characteristics and quality of products and services;
- sales and other taxes; and
- other claims based on the nature and content of Internet materials.

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

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

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

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

It is possible that claims may be asserted against us in the future by former stockholders of Travelzoo.com Corporation seeking to receive our shares, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares under escheat statutes. If such escheat claims are asserted, we intend to challenge the applicability of escheat rights, among other reasons, in that the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, we intend to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. We also expect to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that we are not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, we would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. We are not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in us being required to issue up to an additional approximately 4,087,000 shares of common stock for no additional payment, which would result in substantial dilution of the ownership interests of the other stockholders, and in the our earnings per share, which could adversely affect the market price of the common stock.

On October 15, 2004, we announced a program under which we will make cash payments to persons who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for our shares within the required time period. The accompanying consolidated financial statements include a charge in general and administrative expenses of \$1,137,000 million for these cash payments for the six months ended June 30, 2005 of which \$10,000 remains as a liability as of June 30, 2005. The liability is based on the number of actual requests received from former stockholders through June 30, 2005. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of our common stock price. Our common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. We do not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but we believe that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares

in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding approximately 4,082,000 shares had not submitted claims under the program as of June 30, 2005.

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

We are evaluating our internal controls over financial reporting in order to allow management to report on, and our independent auditors to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the SEC, which we collectively refer to as Section 404. We are currently performing the system and process evaluation and testing required in an effort to comply with the management assessment and auditor certification requirements of Section 404, which will initially apply to us as of December 31, 2005. In the course of our ongoing Section 404 evaluation, we have identified areas of internal controls that may need improvement and have instituted remediation efforts where necessary. We are still in the evaluation process, and we may identify conditions that may result in significant deficiencies or material weaknesses in the future.

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

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

The U.S. Patent and Trademark Office registered the trademark for “Travelzoo” on January 23, 2001. The European Community registered “Travelzoo” as a Community Trademark on May 11, 2004. If we are unable to protect our rights in the mark, a key element of our strategy of promoting *Travelzoo* as a brand could be disrupted and our business could be adversely affected. We may not be able to detect unauthorized use of our proprietary information or take appropriate steps to enforce our intellectual property rights. In addition, the validity, enforceability and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving. The laws of other countries in which we may market our services in the future are uncertain and may afford little or no effective protection of our intellectual property. The unauthorized reproduction or other misappropriation of our proprietary technology could enable third parties to benefit from our technology and brand name without paying us for them. If this were to occur, our business could be materially adversely affected.

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

We cannot be certain that our products, content and brand names do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit, and such claims could result in a significant diversion of the efforts of our management personnel. Successful infringement claims against us may result in monetary liability or a material disruption in the conduct of our business.

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

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

Our U.K. operations expose us to foreign currency risk associated with agreements being denominated in British Sterling Pounds and Euros. Further, we are exposed to foreign currency risk associated with fluctuations of the British Sterling Pounds as the financial position and operating results of our U.K. subsidiary will be translated into U.S. Dollars for consolidation purposes.

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

As of June 30, 2005, we carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s President, Chief Executive Officer and Chief Financial Officer along with the Company’s Controller (Chief Accounting Officer), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange

Act Rule 13a-15. Based upon that evaluation, the Company's President, Chief Executive Officer and Chief Financial Officer along with the Company's Controller (Chief Accounting Officer) concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in our periodic SEC filings as of June 30, 2005.

During the quarter ended June 30, 2005, there was no change in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II—OTHER INFORMATION**

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

The annual meeting of stockholders occurred on June 1, 2005, at which the following individuals were elected as directors: Holger Bartel, Ralph Bartel, David J. Ehrlich, Donovan Neale-May, and Kelly M. Urso. The stockholders also ratified the appointment of KPMG LLP as the Company's independent auditors for the 2005 fiscal year.

The stockholders voted as follows:

Proposals	For	Against	Withhold or Abstain
<b>Election of Directors</b>			
Ralph Bartel	14,541,177	130	362,806
Holger Bartel	14,541,177	130	336,509
David J. Ehrlich	14,895,075	130	8,912
Donovan Neale-May	14,895,075	130	8,912
Kelly M. Urso	14,894,831	130	9,162
<b>Appointment of KPMG</b>	<b>14,894,128</b>	<b>7,600</b>	<b>2,395</b>

### **Item 5. Other Information**

On May 16, 2005, Travelzoo UK Limited, a subsidiary of the Company, entered into a service agreement with Christopher Loughlin for Mr. Loughlin to serve as Managing Director of Travelzoo UK Limited and as Senior Vice President and General Manager, Travelzoo UK of the Company. In exchange for these services, Mr. Loughlin is entitled to receive an annual salary of 118,500 pounds and to participate in the Company's bonus plans. In addition, Mr. Loughlin is entitled to reimbursement of reasonable expenses and to certain relocation costs and expenses. The agreement is for a two year period, commencing on May 16, 2005, and contains non-solicitation and non-compete provisions during the term of the agreement and for six months following the termination of the agreement. This description is qualified in its entirety by reference to the actual agreement, which is filed as Exhibit 10.1 to this report and is incorporated by reference herein.

### **Item 6. Exhibits**

The following table sets forth a list of exhibits:

Exhibit Number	Description
3.1	Certificate of Incorporation of Travelzoo Inc. (Incorporated by reference to our Pre-Effective Amendment No. 6 to our Registration Statement on Form S-4 (File No. 333-55026), filed February 14, 2002)
3.2	By-laws of Travelzoo Inc. (Incorporated by reference to our Pre-Effective Amendment No. 6 to our Registration Statement on Form S-4 (File No. 333-55026), filed February 14, 2002)
10.1*	Christopher Loughlin Service Agreement, dated as of May 16, 2005, between Travelzoo UK Ltd and Christopher Loughlin
31.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Filed herewith



**Travelzoo UK Limited  
Christopher Loughlin  
Service Agreement**

Date: *16 May 2005*  
Document Number: 159453.5  
Matter Number: [                    ]



33 Cannon Street London EC4M 5TE

tel: (+44) (0) 20 7246 5800 — fax: (+44) (0) 20 7246 5858

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THIS AGREEMENT is made the 16th day of May 2005

BETWEEN:

- (1) **Travelzoo UK Limited** (registered number 05442657) whose registered office is at 90 Long Acre, Covent Garden, London WC2E 9RZ (the "Company");
- (2) **Christopher Loughlin** of 53b Fulham Park Gardens, Fulham, London SW6 4LB (the "Executive").

THE PARTIES AGREE as follows:

## 1. Definitions

### 1.1 Definitions

In this Agreement unless the context otherwise requires the following expressions have the following meanings:

"Act"	The Employment Rights Act 1996 as amended;
"Annual Bonus Plan"	an individual bonus plan which applies to the Executive, subject to the terms described in Schedule 1, for the following periods only: (1) the period from May 16, 2005, to December 31, 2005; (2) the period from January 1, 2006, to December 31, 2006; (3) the period from January 1, 2007, to December 31, 2007; and (4) the period from January 1, 2008, to May 15, 2008;
"Board"	the board of directors for the time being of the Company or any committee of directors appointed by the board for the time being;
"Confidential Information"	personnel information, or any information relating to the business, clients/customers, products, users, subscribers, affairs and finances, internal processes, systems and organisation of the Company or of any Group Company for the time being confidential to it or to them or treated by it or them as such and trade secrets (including, without limitation, technical data and know-how) relating to the business of the Company or of any Group Company or of any of its or their suppliers or clients/customers;
"Executive Bonus Plan"	the bonus plan for senior executives of Travelzoo USA as amended on 18 May 2005;
"Group"	the Company and the Group Companies;
"Group Company"	any company (including Travelzoo USA) which is for the time being a subsidiary or holding

company of the Company and any subsidiary of any such holding company and for the purposes of this Agreement the terms "subsidiary" and "holding company" shall have the meanings ascribed to them by sections 736 and 736A Companies Act 1985;

"Quarterly Bonus Plan" an individual bonus plan which applies to the Executive during the term of the Agreement;

"Travelzoo USA" Travelzoo Inc., a company incorporated according to the laws of the State of Delaware and the parent company of the Company.

1.2 References to clauses and schedules are unless otherwise stated to clauses of and schedules to this Agreement.

1.3 The headings to the clauses are for convenience only and shall not affect the construction or interpretation of this Agreement.

1.4 Unless the context otherwise requires, references in this Agreement to the masculine gender shall, where appropriate, be deemed to include the feminine and vice versa.

## **2. Commencement and Term**

2.1 This Agreement shall be deemed to commence on May 16 2005 and shall continue (except as provided in Clause 14) for a fixed period of two years. After the initial fixed period of two years, the Agreement may be terminated at any time by either party giving to the other one year's notice in writing.

2.2 For the purposes of the Act, the Executive's period of continuous employment commenced on November 15, 2001.

## **3. Role and Duties of the Executive**

3.1 The Executive shall serve the Company as Managing Director. He shall also serve Travelzoo USA as Senior Vice President and General Manager, Travelzoo UK.

3.2 During his employment the Executive shall:

3.2.1 devote the whole of his time, attention and skill to the business and affairs of the Company both during normal business hours and during such additional hours as are necessary for the proper performance of his duties or as the Board may reasonably require from time to time;

3.2.2 faithfully and diligently perform such duties and exercise such powers consistent with his position as may from time to time be assigned to him to a standard that is acceptable to the Board;

3.2.3 obey the reasonable and lawful directions of the Board;

3.2.4 comply with all the Company's rules, regulations, policies and procedures from time to time in force; and

- 3.2.5 keep the Board at all times promptly and fully informed (in writing if so requested) of his conduct of the business of the Company and any Group Company and provide such explanations in connection with it as the Board may require.
- 3.3 The Executive agrees, for the purposes of Regulation 5 of The Working Time Regulations 1998 (the “Regulations”), that Regulation 4 of the Regulations does not apply to him. The Company and the Executive agree that the Executive’s consent, for the purpose of this Clause 3.3, shall continue indefinitely provided that the Executive may withdraw such consent at any time by giving the Company three months’ notice of his wish to do so.
- 3.4 The Executive shall, if and so long as the Company requires and without any further remuneration other than is specified in this Agreement:
- 3.4.1 carry out duties on behalf of any Group Company; and
- 3.4.2 act as a director or officer of any Group Company.
- 3.5 The Company may at its sole discretion transfer this Agreement to any Group Company at any time.

#### **4. Place of Work**

The Executive’s place of work will be the Company’s offices at 90 Long Acre, Covent Garden, London WC2E 9RZ, but the Company may require the Executive to work at any place (whether inside or outside the United Kingdom) for such periods as the Company may from time to time require.

#### **5. Remuneration**

- 5.1 The Company shall pay to the Executive, by credit transfer to his bank account, an annual salary of £118,500 payable by equal monthly instalments in arrears for the previous month on or before the first day of each calendar month.
- 5.2 The Executive shall also be entitled to participate in a Quarterly Performance Bonus Plan, an Annual Bonus Plan, and the Executive Bonus Plan of Travelzoo USA, the terms of which are set out in the Schedule to this Agreement.
- 5.3 Salary and any bonus payable shall be inclusive of any fees to which the Executive may be entitled as a director of the Company or any Group Company.
- 5.4 Payment of salary and bonus (if applicable) to the Executive shall be made either by the Company or by a Group Company and, if by more than one company, in such proportions as the Board may from time to time think fit.

#### **6. Expenses**

- 6.1 The Company shall reimburse the Executive in respect of all expenses reasonably incurred by him in the proper performance of his duties, subject to the Company’s policies and his providing such receipts or other appropriate evidence as the Company may require.

## **7. Holidays**

- 7.1 The Executive shall be entitled, in addition to all Bank and public holidays normally observed in England, to 20 working days' paid holiday in each holiday year (being the period from 1 January to 31 December). This entitlement is subject to the following provisions of this clause.
- 7.2 The Executive may take his holiday only at such times as are agreed with the Chairman of the Company. Such agreement is to be obtained before the Executive commits himself to bookings or other positive arrangements.
- 7.3 No holiday may be carried forward to the next holiday year, except with the express written consent of the Company.
- 7.4 The Executive will not be entitled to pay for any unused holiday entitlement (except on the termination of his employment).

## **8. Sickness Benefit**

- 8.1 There is no contractual right to payment in respect of periods of absence due to sickness or incapacity, but such payments are at the discretion of the Company.
- 8.2 Any payment to the Executive pursuant to Clause 8.1 shall be deemed to include any Statutory Sick Pay and any Social Security Sickness Benefit or other benefits to which the Executive may be entitled.
- 8.3 If so required, the Executive agrees to supply the Company with medical certificates covering any period of sickness or incapacity exceeding seven days (including weekends) and to undergo, at the Company's expense, a medical examination by a doctor appointed by the Company (and the Executive agrees that copies of any medical reports prepared by such doctor shall be sent directly to the Company).

## **9. Pension and Medical Expenses Insurance**

- 9.1 During his employment, the Executive shall be eligible to join the Company's stakeholder pension scheme, currently planned to be with Scottish Widows and to take effect from June 1, 2005. The pension scheme is contracted in to the state earnings-related pension scheme and a contracting out certificate under the Pension Scheme Act 1993 is not in force.
- 9.2 During his employment, the Executive and his spouse shall be entitled to participate in any private health insurance scheme that may be arranged by the Company for its executives subject to the insurer accepting the Executive for cover under the relevant policy at normal rates and subject to the rules of such scheme or policy from time to time in force.

## **10. Relocation Arrangements and Expenses**

- 10.1 The Company and the Executive agree that his employment constitutes a local hire position.

- 10.2 The Company will reimburse the Executive's reasonable moving expenses up to a total value of £4,100 upon submission of valid receipts. Receipts must be submitted within 30 calendar days of the expenses being incurred.
- 10.3 The Company will pay for the Executive's temporary housing in London for the period from May 1 2005 to October 31 2005 (the first six months), subject to an upper limit of £8,316 and subject to the production of valid receipts.
- 10.4 The Company will use reasonable efforts to try to obtain a UK visa for the Executive's spouse and will pay for the legal expenses in this regard (not to exceed a total of £5,500).
- 10.5 The Company will pay for six economy class tickets from the US to London between the period May 16 2005 and May 31 2006 for the Executive's spouse.
- 10.6 The above expenses and allowances will be provided on the condition that the Executive relocates to London on or before June 1 2005, and are to be repaid to the Company by the Executive if the Executive should leave the Company's employment voluntarily, or if his employment terminates on any of the grounds set out in Clause 14.1, within twelve months of the commencement of this Agreement.

## **11. Restrictions During His Employment**

- 11.1 During his employment, the Executive shall not directly or indirectly:
    - 11.1.1 be employed, engaged, concerned or interested in any other business or undertaking; or
    - 11.1.2 engage in any activity which the Board reasonably considers may be, or become, harmful to the interests of the Company or of any Group Company or which might reasonably be considered to interfere with the performance of the Executive's duties under this Agreement.
  - 11.2 The Executive agrees that he will not at any time during the course of his employment take any preparatory steps to become engaged or interested in any capacity whatsoever in any business or venture which is in or is intended to enter into competition with any business of the Company.
  - 11.3 During the term of this Agreement, the Executive shall not whether alone or jointly with or on behalf of any other person, firm or company and whether as principal, partner, manager, employee, contractor, director, consultant, investor or otherwise (except as a representative or nominee of the Company or any Group Company or otherwise with the prior consent in writing of the Board) be engaged, concerned or interested in any other business or undertaking which is wholly or partly in competition with any business carried on by the Company or any Group Company provided that the Executive may hold (directly or through nominees) by way of bona fide personal investment any units of any authorised unit trust and up to one per cent of the issued shares, debentures or other securities of any class of any company whose shares are listed on a recognised investment exchange within the meaning of section 285 of the Financial Services and Markets Act 2000 ("FSMA") or dealt in the Alternative Investment Market or any such other exchange as may be specified by the Board from time to time.
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## **12. Confidential Information and Company Property**

- 12.1 The Executive shall neither during his employment (except in the proper performance of his duties) nor at any time (without limit) after the termination of his employment except in compliance with an order of a competent court:
- 12.1.1 divulge or communicate to any person, company, business entity or other organisation any Confidential Information;
  - 12.1.2 use any Confidential Information for his own purposes or for any purposes other than those of the Company or any Group Company; or
  - 12.1.3 through any failure to exercise due care and diligence, permit or cause any unauthorised disclosure of any Confidential Information.
- 12.2 The Executive acknowledges that all books, notes, memoranda, records, lists of clients/customers and suppliers and employees and users and subscribers, correspondence, documents, computer and other discs and tapes, data listings, codes and other documents and material whatsoever (whether made or created by the Executive or otherwise) relating to the business of the Company or any Group Company (and any copies of the same):
- 12.2.1 shall be and remain the property of the Company or the relevant Group Company; and
  - 12.2.2 shall be handed over by the Executive to the Company or to the relevant Group Company on demand and in any event on the termination of his employment and the Executive shall certify that all such property has been handed over on request by the Board and agrees that he will take all reasonable steps to prevent the disclosure of the same.

## **13. Inventions and Other Intellectual Property**

- 13.1 The parties foresee that the Executive may make inventions or create other intellectual property in the course of his duties and agree that in this respect the Executive has a special responsibility to further the interests of the Company and the Group Companies.
- 13.2 Any invention, improvement, design, process, information, copyright work, trade mark or trade name or get-up made, created or discovered by the Executive in the course of his employment (whether capable of being patented or registered or not and whether or not made or discovered in the course of his employment) in conjunction with or in any way affecting or relating to the business of the Company or of any Group Company or capable of being used or adapted for use in or in connection with such business (“Intellectual Property Rights”) shall be disclosed immediately to the Company and shall (subject to sections 39 to 43 Patents Act 1977) belong to and be the absolute property of the Company or such Group Company as the Company may direct.
- 13.3 If and whenever required so to do by the Company, the Executive shall at the expense of the Company or such Group Company as the Company may direct:
- 13.3.1 apply or join with the Company or such Group Company in applying for letters patent or other protection or registration for any other Intellectual Property Rights in the United Kingdom and in any other part of the world; and

- 13.3.2 execute all instruments and do all things necessary for vesting all such right, title and interest in such letters patent or other Intellectual Property Rights in the Company or such Group Company or such other person as the Company may specify absolutely as sole beneficial owner.
- 13.4 The Executive irrevocably and unconditionally waives all rights under Chapter IV of Part I of the Copyright, Designs and Patents Act 1988 in connection with his authorship of any existing or future copyright work in the course of his employment, in whatever part of the world such rights may be enforceable including, without limitation:
- 13.4.1 the right conferred by section 77 of that Act to be identified as the author of any such work; and
- 13.4.2 the right conferred by section 80 of that Act not to have any such work subjected to derogatory treatment.
- 13.5 The Executive irrevocably appoints the Company to be his Attorney in his name and on his behalf to execute any such instrument or do any such thing and generally to use his name for the purpose of giving to the Company the full benefits of this Clause 13. A certificate in writing in favour of any third party signed by any director or by the Secretary of the Company that any instrument or act falls within the authority conferred by this Agreement shall be conclusive evidence that such is the case.
- 13.6 Nothing in this Clause 13 shall be construed as restricting the rights of the Executive or the Company under sections 39 to 43 Patents Act 1977.

#### **14. Termination**

- 14.1 Notwithstanding any other provisions of this Agreement, in any of the following circumstances, the Company may terminate the Executive's employment summarily and without further payment (save for any sums accrued due as at the relevant date) if the Executive:
- 14.1.1 commits any serious breach of this Agreement or is guilty of any gross misconduct or any wilful neglect in the discharge of his duties;
- 14.1.2 repeats or continues (after warning) any breach of this Agreement;
- 14.1.3 is guilty of any fraud, dishonesty or any conduct tending to bring himself, the Company, or any Group Company into disrepute;
- 14.1.4 has a petition presented for a bankruptcy order to be made in respect of him, enters into (or proposes to enter into) an individual voluntary arrangement or other composition with his creditors or takes advantage of any other legislation for the time being in force offering relief for insolvent debtors;
- 14.1.5 is convicted of any criminal offence (other than minor offences under the Road Traffic Acts or the Road Safety Acts for which a fine or non-custodial penalty is imposed) which might reasonably be thought to affect adversely the performance of his duties;

14.1.6 is disqualified from holding office in the Company or in any other company by reason of any order made under the Company Directors Disqualification Act 1986 or any other enactment;

14.1.7 resigns as or otherwise ceases to be or becomes prohibited by law from being a director of the Company, otherwise than at the Company's request; or

Any delay by the Company in exercising such right of termination shall not constitute a waiver of it.

- 14.2 If at any time the Executive is unable to perform his duties properly because of ill health, accident or otherwise for a period or periods totalling at least 130 working days in any period of 12 calendar months, or becomes incapable by reason of mental disorder of managing and administering his property and affairs, then the Company may terminate his employment by giving him not less than statutory minimum written notice to that effect and the Executive will have no entitlement, in such circumstances, to payment other than in respect of statutory minimum notice.
- 14.3 If the Company believes that it may be entitled to terminate his employment pursuant to Clause 14.1, it shall be entitled (but without prejudice to its right subsequently to terminate his employment on the same or any other ground) to suspend the Executive on full pay and other benefits for so long as it may think fit.
- 14.4 The Company reserves the right, at its absolute discretion, to terminate the Executive's employment at any time by making a payment in lieu of any notice of termination and/or in lieu of the balance of the fixed term of employment corresponding either to the applicable period(s) as set out in Clause 2, or Clause 14.2 in the case of serious incapacity. For this purpose, the Executive agrees that pay in lieu will consist of basic salary only (and no bonus payments) for the fixed term and/or notice period which is accrued due as at the date of termination of his employment.
- 14.5 On the termination of his employment or upon either the Company or the Executive having served notice of such termination, the Executive shall, at the request of the Company, resign from office as a director of the Company and all offices held by him in any Group Company provided however that such resignation shall be without prejudice to any claims which the Executive may have against the Company or any Group Company arising out of the termination of his employment; and the Executive irrevocably authorises the Company to appoint any person in his name and on his behalf to sign any documents and do any things necessary or requisite to give effect to his obligations under this Clause 14.5.
- 14.6 If (a) the Company in a general meeting shall remove the Executive from the office of director of the Company or any Group Company, or (b) under the Articles of Association for the time being of the Company or any Group Company, the Executive shall be obliged to retire by rotation or otherwise and the Company in general meeting shall fail to re-elect the Executive as a director of the relevant Group Company (either such case being referred to in this Clause 14.6 as an "Event"), then the Executive's employment under this Agreement shall automatically terminate with effect from the date of the Event, and no payment in lieu of notice or in lieu of the balance of a fixed term shall be due to him.

- 14.7 The Executive acknowledges the right of the Company to monitor and control the performance of its employees and acknowledges the fiduciary obligations attaching to his position including obligations to inform the Board forthwith upon his becoming aware that any of his colleagues engaged in the business of any Group Company of which he is a director is intending or contemplating the termination of his contract of employment with the Company of any other company in the Group.
- 14.8 Without prejudice to any other provisions of this Agreement, the Executive may not (except in the legitimate performance of his duties as an employee) at any time and specifically not on the termination of his employment, delete, copy, forward to a third party or interfere in any way with any Company information (including e-mails or documents relating to Company business) held on a laptop or computer or other electronic device and any attempt to do so will be regarded as gross misconduct.
- 15. Garden Leave**
- 15.1 At any time including after notice to terminate employment has been given by the Executive or the Company, the Board may for all or part of the duration of the notice period in its absolute discretion require the Executive:
- 15.1.1 to perform only such duties (including without limitation research projects) as it may allocate to the Executive;
  - 15.1.2 not to perform any duties;
  - 15.1.3 not to have any contact with clients/customers of the Company or any Group Company;
  - 15.1.4 not to have any contact with such employees or suppliers of the Company or any Group Company as the Board shall determine;
  - 15.1.5 to disclose to the Board any attempted contact (other than purely social contact) with him made by any client, employee or supplier with whom the Executive has been required to have no contact pursuant to this sub-clause;
  - 15.1.6 to take any accrued holiday entitlement;
  - 15.1.7 not to enter any premises of the Company or any Group Company nor to visit the premises of any of the Company's or any Group Company's suppliers or customers;
  - 15.1.8 to resign as a director of the Company or from any other office held by him in the Company or any other Group Company;
- provided always that throughout the period of any such action and subject to the other provisions of this Agreement the Executive's salary and contractual benefits shall not cease to accrue or be paid (subject to Clause 15.3 below) and provided further that the period of garden leave shall not be for a period exceeding six months in total.
- 15.2 The Executive acknowledges that such action as set out above taken on the part of the Company shall not constitute a breach of this Agreement of any kind whatsoever nor shall the Executive have any claim against the Company in respect of any such action.

15.3 During any period of garden leave, the Executive shall owe a duty of the utmost good faith to the Company and its Group Companies, must not work for any other person or on his own account and shall remain readily contactable and available to work for the Company or any Group Company. Should the Executive work for any other person or on his own account or fail to be available for work at any time having been requested by the Company to do so or otherwise be in breach of any of the provisions of this Agreement, the Executive's right to salary and contractual benefits in respect of such period of non compliance shall be forfeit notwithstanding any other provision of this Agreement.

## **16. Restrictive Covenants**

16.1 The Executive will not for a period of six months (less any period during which the Executive has been on garden leave) after the termination of his employment whether as principal or agent, and whether alone or jointly with, or as a director, manager, partner, shareholder, employee or consultant of any other person, directly or indirectly:

16.1.1 solicit or canvass (or seek to canvass or solicit) any business, order or custom of any Client of the Company. For the purposes of this clause, "Client" shall mean any person, firm or entity who shall have advertised products or services in any of the Company's or Group Company's publications or products and with whom the Executive has had material dealings at any time in the six months prior to the termination of the his employment. "Client" shall also include any prospective client, which shall mean any potential advertiser in any of the Company's or Group Company's publications or products with whom the Executive has had material dealings at any time in the last six months before the termination of his employment and in relation to which there were material prospects of obtaining business at the time his employment terminated;

16.1.2 perform services for or engage in any business that generates revenue principally from the development, publication or sale of online advertisements for travel companies.

16.2 None of the restrictions contained in Clause 16.1 shall prohibit any activities by the Executive which are not in direct or indirect competition with any on-line travel advertisement business being carried on by the Company or by any Group Company at the date of the termination of his employment.

16.3 Nothing in Clause 16.1 shall preclude the Executive from holding (directly or through nominees) investments in the amount and of the type specified in Clause 11.3.

16.4 At no time after the termination of his employment shall the Executive directly or indirectly represent himself as being interested in or employed by or in any way connected with the Company or any Group Company, other than as a former employee of the Company.

16.5 The Executive acknowledges and agrees that he shall be obliged to draw the provisions of this clause to the attention of any third party who may at any time before or after the termination of the Executive's employment offer to employ or engage the Executive and for whom or with whom the Executive intends to work at any time during 12 months after the termination of his employment.

16.6 The Executive agrees that, having regard to all the circumstances and having taken independent legal advice, the restrictions contained in this clause are reasonable and necessary for the protection of the Company and the Group Companies and that they do not bear harshly upon him and the parties agree that:

16.6.1 each restriction shall be read and construed independently of the other restrictions so that if one or more are found to be void or unenforceable as an unreasonable restraint of trade or for any other reason the remaining restrictions shall not be affected; and

16.6.2 if any restriction is found to be void but would be valid and enforceable if some part of it were deleted, that restriction shall apply with such deletion as may be necessary to make it valid and enforceable.

## **17. Disciplinary and Grievance Procedure**

The Executive is referred to Schedule 2 to this Agreement for the Company's Disciplinary and Grievance Procedure.

## **18. Data Protection and Communications**

18.1 The Executive consents to the Company or any Group Company holding and processing both electronically and manually the data (including personal sensitive data and information contained in e-mail and e-mail attachments) it collects, stores and/or processes, which relates to the Executive for the purposes of the administration and management of its business. It may also be necessary for the Company to forward such personal information to other offices or any Group Company may have outside the European Economic Area (and, in particular, to the United States) where such company has offices or storage for the processing for administrative purposes and the Executive consents to the Company doing so as may be necessary from time to time.

18.2 To ensure the protection of its workers, clients/customers and business, the Company reserves the right to monitor, intercept, review and access the Executive's telephone log, internet usage, voicemail, e-mail and other communication facilities provided by the Company which he may use during his employment with the Company. The Company will use this right of access reasonably, but it is important that the Executive is aware that all communications and activities on the Company's/any Group Company's equipment or premises cannot be presumed to be private.

## **19. Notices**

A notice may be given by any party hereto to any other party hereto either personally or by sending it by prepaid first class post or airmail to his address stated in this Agreement or to any other address supplied by him to the other parties hereto for the giving of notice to him. A properly addressed and prepaid notice sent by post shall be deemed to have been served at an address within the United Kingdom at the expiry of 48 hours after the notice is posted and to have been served at an address outside the United Kingdom at the expiry of 72 hours after the notice is posted.

## **20. Deductions**

- 20.1 The Executive shall pay to the Company any sums owing by him to the Company upon demand by the Company at any time (whether during the Executive's employment by the Company or after the termination Date).
- 20.2 For the purposes of the Act and otherwise, the Executive consents to the deduction from his wages or from any other sums owed to the Executive by the Company of any sums owing by him to the Company at any time.
- 20.3 This clause is without prejudice to the rights of the Company to recover any sums or balance of sums owing by the Executive to the Company by legal proceedings.

## **21. Former Contracts of Employment**

This Agreement shall be in substitution for any previous contracts, whether by way of letters of appointment, agreements or arrangements, whether written, oral or implied, relating to the employment of the Executive (including all bonus arrangements), (whether by Travelzoo USA or by the Company or any other Group Company) which shall be deemed to have been terminated by mutual consent as from the date of this Agreement and the Executive acknowledges to the Company for itself and on behalf of each Group Company that he has no outstanding claims of any kind against the Company or any Group Company in respect of any such contract.

## **22. General**

- 22.1 The Executive acknowledges that the provisions of Clauses 12, 13 and 16 constitute separate undertakings given for the benefit of each Group Company and may be enforced by any of them.
- 22.2 The expiration or termination of this Agreement shall not prejudice any claim which either party may have against the other in respect of any pre-existing breach of or contravention of or non-compliance with any provision of this Agreement nor shall it prejudice the coming into force or the continuance in force of any provision of this Agreement which is expressly or by implication intended to or has the effect of coming into or continuing in force on or after such expiration or termination.
- 22.3 This Agreement constitutes the written statement of the terms of employment of the Executive provided in compliance with Part I of the Act.
- 22.4 Save as otherwise herein provided, there are no terms or conditions of employment relating to hours of work or to normal working hours or to entitlement to holiday (including public holidays) or holiday pay or to incapacity for work due to sickness or injury or to pensions or pension schemes or to requirements to work abroad and no collective agreement has any effect upon the Executive's employment under this Agreement.
- 22.5 No term in this Agreement is enforceable under the Contracts (Rights of Third Parties) Act 1999 but this does not affect any right or remedy of a third party which exists or is available apart from that Act.

**23. Choice of Law and Submission to Jurisdiction**

23.1 This Agreement shall be governed by and interpreted in accordance with English law.

23.2 The parties submit to the exclusive jurisdiction of the English courts, but this Agreement may be enforced by the Company in any court of competent jurisdiction.

**IN WITNESS** whereof this Agreement has been executed as a deed by the Executive the day and year first written above.

Signed by Ralph Bartel for and )  
on behalf of the Company )

\_\_\_\_\_  
Director

Executed and delivered as a Deed by )  
the Executive in the presence of )

\_\_\_\_\_

\_\_\_\_\_  
Witness Signature

Witness name:

Witness address:

## **Schedule 1**

### **Quarterly Performance Bonus Plan**

The Executive will be eligible to participate in a quarterly performance bonus plan which provides up to £20,000 per calendar quarter. The performance bonus depends to the extent of which the Company meets its business goals as determined by the Board of the Company and the Chief Financial Officer of Travelzoo USA and the assessment of the Executive's performance by the Chairman of the Company. The calculation of the quarterly performance bonus will be based on the official budget for the Company (to be approved by the Chairman of the Company and by the Chief Financial Officer of Travelzoo USA), which will include quarterly targets for revenues, net income and subscribers, and a quarterly assessment of the Executive's performance by the Chairman of the Company, which will focus on the Executive's motivation and the quality of the UK Company's publications and products and advertiser base.

The following criteria will apply in relation to the quarterly performance bonus plan:

<b>Criteria</b>	<b>Quarterly Bonus Payment</b>
Revenue goal as defined in official budget for Travelzoo UK met?	£ 5,000
Net income goal as defined in official budget for Travelzoo UK met?	£ 5,000
Subscriber goal as defined in official budget for Travelzoo UK met?	£ 5,000
Performance evaluation by the Chairman of the Company	Up to £ 5,000
<b>Total</b>	<b>Up to £20,000</b>

The quarterly bonus will be paid less statutory deductions, within 45 days after the end of the quarter, on condition that the Executive is in employment on the relevant bonus payment date, or in the case of the quarter covering May 15, 2008, he must be in employment on that date.

Any bonus payments for periods beginning after the first day of a calendar quarter or ending before the last day of a calendar quarter will be pro rata.

### **Annual Bonus Plan**

In addition, for (1) the period from May 16, 2005, to December 31, 2005; (2) the period from January 1, 2006, to December 31, 2006; (3) the period from January 1, 2007, to December 31, 2007; and (4) the period from January 1, 2008, to May 15, 2008 only under an Annual Bonus Plan, the Executive will be eligible to receive a 15% profit share based on the Company's pro forma operating income (before expenses relating to the profit sharing plan and before taxes) generated from sales and/or operations in the UK. The Annual Bonus will be calculated for the following four periods: (1) the period from May 16, 2005, to December 31, 2005; (2) the period from January 1, 2006, to December 31, 2006; (3) the period from January 1, 2007, to December 31, 2007; and (4) the period from January 1, 2008, to May 15, 2008. The Annual Bonus will be

determined within 30 days after the end of each period by the Chief Financial Officer of Travelzoo USA and the Company's Chairman and is payable within 60 days after the end of the respective period.

The profit share under the Annual Bonus Plan is capped at £667,000 in the year 2005, £1,000,000 in each of the years 2006 and 2007, and £333,000 in the year 2008. In order to be eligible for the Annual Bonus Plan for any of the four periods as defined above, the Executive must be employed by the Company on the last day of the respective period. The profit share under the Annual Bonus Plan will be paid less statutory deductions.

For the avoidance of doubt the Annual Bonus Plan will only apply to the following four periods during the Executive's employment: (1) the period from May 16, 2005, to December 31, 2005; (2) the period from January 1, 2006, to December 31, 2006; (3) the period from January 1, 2007, to December 31, 2007; and (4) the period from January 1, 2008, to May 15, 2008. No Annual Bonus will be paid for any periods after May 15, 2008.

#### **Executive Bonus Plan of Travelzoo USA**

As a member of Travelzoo USA's Executive Team, the Executive will also participate in the current Executive Bonus Plan of Travelzoo USA, subject to the terms of the Executive Bonus Plan and continuation of that plan. Travelzoo USA reserves the right to amend or withdraw the Executive Bonus Plan at any time.

Any bonus payable under the Executive Bonus Plan will be paid, less statutory deductions, within 45 days after the end of the calendar quarter.

## **Schedule 2**

### **Procedures in relation to Dismissal/Disciplinary Action**

In relation to any proposed dismissal or disciplinary action, the Company will observe the standard or modified dismissal and disciplinary procedure, as may be required in the relevant case. These procedures are set out below:

#### **Standard Dismissal and Disciplinary Procedure**

##### Step 1: Statement of grounds for action and invitation to meeting

- The Company will set out in writing your alleged conduct or characteristics, or other circumstances, which led it to contemplate dismissing or taking disciplinary action against you.
- The Company will send the statement or a copy of it to you and invite you to attend a meeting to discuss the matter.

##### Step 2: Meeting

- The meeting will take place before action is taken, except in the case where the disciplinary action consists of suspension.
- The meeting will not take place unless:
  - (a) the Company has informed you what the basis was for including in the statement under Step 1 the ground or grounds given in it; and
  - (b) you have had a reasonable opportunity to consider your response to that information.
- You must take all reasonable steps to attend the meeting.
- After the meeting, the Company will inform you of its decision and notify you of the right to appeal against the decision if you are not satisfied with it.
- You have the right to be accompanied at the meeting by a work colleague or a trade union representative.

##### Step 3: Appeal

- If you wish to appeal, you must inform the Company in writing.
- If you inform the Company of your wish to appeal, the Company will invite you to attend a further meeting.
- You must take all reasonable steps to attend the meeting.

- The appeal meeting need not take place before the dismissal or disciplinary action takes effect.
- After the appeal meeting, the Company will inform you of its final decision.
- Where reasonably practicable, the appeal should be dealt with by a more senior manager than attended the first meeting (unless the most senior manager attended that meeting).
- You have the right to be accompanied at the meeting by a work colleague or a trade union representative.

### **Modified Dismissal and Disciplinary Procedure**

#### Step 1: Statement of grounds for action

- The Company will set out in writing — (i) your alleged misconduct which has led to the dismissal (ii) the reasons for thinking at the time of the dismissal that you were guilty of the alleged misconduct and (iii) your right to appeal against dismissal.
- The Company will send the statement, or a copy of it, to you.

#### Step 2: Appeal

- If you wish to appeal, you must inform the Company.
- If you inform the Company of your wish to appeal, the Company will invite you to attend a meeting.
- You must take all reasonable steps to attend the meeting.
- After the appeal meeting, the Company will inform you of its final decision.
- Where reasonably practicable, the appeal should be dealt with by a more senior manager not involved in the earlier decision to dismiss.
- You have the right to be accompanied at the appeal meeting by a work colleague or a trade union representative.

## Grievance Procedure

### *Step 1: statement of grievance*

- You must set out the grievance in writing and send the statement or a copy of it to the Company.

### *Step 2: meeting*

- The Company must invite you to attend a meeting to discuss the grievance.
- The meeting must not take place unless:
  - (a) you have informed the Company what the basis for the grievance was when you made the statement under Step 1 above; and
  - (b) the Company has had a reasonable opportunity to consider its response to that information.
- You must take all reasonable steps to attend the meeting.
- After the meeting, the Company must inform you of its decision as to its response to the grievance and notify you of the right to appeal against the decision if you are not satisfied with it.
- You have the right to be accompanied at the meeting by a work colleague or a trade union representative.

### *Step 3: appeal*

- If you do wish to appeal, you must inform the Company.
- If you inform the Company of your wish to appeal, the Company must invite you to attend a further meeting.
- You must take all reasonable steps to attend the meeting.
- After the appeal meeting, the Company must inform you of its final decision.
- Where reasonably practicable, the appeal should be dealt with by a more senior manager than attended the first meeting (unless the most senior manager attended that meeting).
- You have the right to be accompanied at the meeting by a work colleague or a trade union representative.

## **Modified Grievance Procedure**

### ***Step 1: statement of grievance***

- You must:
  - (a) set out in writing — (i) the grievance, and (ii) the basis for it, and
  - (b) send the statement, or a copy of it, to the Company.

### ***Step 2: response***

- The Company must set out its response in writing and send the statement or a copy of it to you.



