

TRAVELZOO INC

FORM 10-Q (Quarterly Report)

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Address	590 MADISON AVENUE 21ST FLOOR NEW YORK, New York 10022
Telephone	212-521-4200
CIK	0001133311
Industry	Computer Services
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 March 31, 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 May 10, 2005, the registrant had outstanding 16,250,479 shares of its \$0.01 par value common stock.

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>March 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 29,514,706	\$ 26,434,989
Short term investments	10,088,326	10,031,738
Accounts receivable, less allowance for doubtful accounts of \$143,129 and \$127,547 as of March 31, 2005 and December 31, 2004, respectively	6,475,738	5,327,279
Deposits	160,672	163,130
Prepaid expenses and other current assets	348,886	674,208
Deferred income taxes	370,559	390,895
Total current assets	<u>46,958,887</u>	<u>43,022,239</u>
Deposits, less current portion	14,700	—
Deferred income taxes	43,237	43,237
Property and equipment, net	122,490	108,399
Intangible assets, net	67,053	83,563
Total assets	<u>\$ 47,206,367</u>	<u>\$ 43,257,438</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 728,749	\$ 439,425
Accrued expenses	2,686,690	2,464,269
Deferred revenue	152,567	91,137
Income tax payable	1,236,448	—
Total liabilities	<u>4,804,454</u>	<u>2,994,831</u>
Commitments and Contingencies		
Stockholders' equity:		
Common stock	162,505	162,332
Additional paid-in capital	30,606,705	30,299,991
Retained earnings	11,632,703	9,800,284
Total stockholders' equity	<u>42,401,913</u>	<u>40,262,607</u>
Total liabilities and stockholders' equity	<u>\$ 47,206,367</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 March 31,	
	2005	2004
Revenues	\$ 11,228,420	\$ 6,462,233
Cost of revenues	179,278	179,343
Gross profit	<u>11,049,142</u>	<u>6,282,890</u>
Operating expenses:		
Sales and marketing	5,029,719	3,457,309
General and administrative	2,608,007	1,114,986
Total operating expenses	<u>7,637,726</u>	<u>4,572,295</u>
Income from operations	3,411,416	1,710,595
Interest income	159,854	5,482
Income before income taxes	3,571,270	1,716,077
Income taxes	1,738,851	706,971
Net income	<u>\$ 1,832,419</u>	<u>\$ 1,009,106</u>
Basic net income per share	\$ 0.11	\$ 0.05
Diluted net income per share	\$ 0.10	\$ 0.05
Shares used in computing basic net income per share	<u>16,232,862</u>	<u>19,425,147</u>
Shares used in computing diluted net income per share	<u>18,132,083</u>	<u>20,648,342</u>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	<u>Three Months Ended March 31,</u>	
	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Net income	\$ 1,832,419	\$ 1,009,106
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,741	39,853
Deferred income taxes	20,336	—
Provision for losses on accounts receivable	27,582	74,703
Tax benefit of stock option exercises	396,067	—
Accrued interest income from short-term investments	(56,588)	—
Changes in operating assets and liabilities:		
Accounts receivable	(1,176,041)	(1,026,390)
Deposits	(12,242)	(4,000)
Prepaid expenses and other current assets	325,321	(44,730)
Accounts payable	289,324	517,211
Accrued expenses	222,422	(167,475)
Deferred revenue	61,430	52,394
Income tax payable	1,236,448	(538,734)
Net cash provided by (used in) operating activities	<u>3,211,219</u>	<u>(88,062)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(42,322)	(9,410)
Net cash used in investing activities	<u>(42,322)</u>	<u>(9,410)</u>
Cash flows from financing activities:		
Issuance costs incurred in connection with 2004 issuance of common stock	(123,730)	—
Proceeds from stock option exercises	34,550	—
Net cash used in financing activities	<u>(89,180)</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	3,079,717	(97,472)
Cash and cash equivalents at beginning of period	26,434,989	3,521,637
Cash and cash equivalents at end of period	<u>\$ 29,514,706</u>	<u>\$ 3,424,165</u>
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	<u>\$ 86,000</u>	<u>\$ 1,245,705</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 site (www.travelzoo.com), the *Travelzoo Top 20* e-mail newsletter, 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 April 25, 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 three months ended March 31, 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 stockholders (“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. As of March 31, 2005, there were 16,250,479 shares of common stock outstanding, and earnings per share calculations reflect the reduction of the number of shares reported as outstanding during the period.

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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 4,087,000 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 \$984,000 for these cash payments for the three months ended March 31, 2005 of which \$162,000 remains as a liability as of March 31, 2005. The liability is based on the number of actual requests received from former stockholders through March 31, 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 approximately 4,087,000 shares had not submitted claims under the program as of March 31, 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 derived from the sale of advertising on the *Travelzoo* Web site, in the *Travelzoo Top 20* e-mail newsletter, in *Newsflash*, and in *SuperSearch*.

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.

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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 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 three months ended March 31, 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:

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	Three Months Ended	
	March 31	
	2005	2004
Basic net income per share:		
Net income	\$ 1,832,419	\$ 1,009,106
Weighted average common shares	16,232,862	19,425,147
Basic net income per share	\$ 0.11	\$ 0.05
Diluted net income per share:		
Net income	\$ 1,832,419	\$ 1,009,106
Weighted average common shares	16,232,862	19,425,147
Effect of dilutive securities: stock options	1,899,221	1,223,195
Diluted weighted average common shares	18,132,083	20,648,342
Diluted net income per share	\$ 0.10	\$ 0.05

(5) Commitments and Contingencies

The Company leases office space in Chicago, Miami, Mountain View (California), and New York, under operating leases which expire on December 31, 2005, December 31, 2006, December 31, 2005 and December 31, 2005, respectively. The future minimum rental payments under these operating leases as of March 31, 2005 and December 31, 2004 total \$932,000 and \$1,082,000, respectively. The future lease payments consist of \$822,000 of payments due in 2005 and \$110,000 of payments due in 2006.

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 4,087,000 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 \$984,000 for these cash payments for the three months ended March 31, 2005 of which \$162,000 remains as a liability as of March 31, 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 4,087,000 shares had not submitted claims under the program.

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(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 March 31, 2005, the Company had one operating segment, online advertising.

Significant customer information is as follows:

Customer	Percent of Revenues		Percent of Accounts Receivable	
	Three Months Ended March 31,		March 31,	December 31,
	2005	2004	2005	2004
A	18%	*	21%	19%
B	*	*	*	13%
C	12%	*	14%	11%

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

* Less than 10%

(7) 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. Although there are no unvested stock-based compensation awards as of March 31, 2005, the Company may grant such instruments in the future. As a result, 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.

(8) Subsequent Events

On April 12, 2005, the Company announced in a press release the opening of an office in London. On May 4, 2005, the Company incorporated Travelzoo UK Limited as a private limited company in the United Kingdom. Travelzoo UK Limited will operate as a wholly-owned subsidiary of Travelzoo Inc.

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.

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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 site (www.travelzoo.com), the *Travelzoo Top 20* e-mail newsletter, 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 site, in the *Travelzoo Top 20* e-mail newsletter, in the *Newsflash* e-mail product, and in *SuperSearch*, a pay-per-click travel search engine. Revenues are principally generated from the sale of advertising 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 \$2,000 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 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 site;
- 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.

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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. 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. 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.

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	Three Months Ended March 31,	
	2005	2004
Revenues	100%	100%
Cost of revenues	2	3
Gross profit	98	97
Operating expenses:		
Sales and marketing	45	54
General and administrative	23	17
Total operating expenses.	68	71
Income from operations	30	26
Other income and expenses, net	2	—
Income before income taxes	32	27
Income taxes	16	11
Net income	16%	16%

For the three months ended March 31, 2005, we reported income from operations of approximately \$3.4 million. As of March 31, 2005, we had retained earnings of approximately \$11.6 million. Our operating margin increased to 30.4% of sales for the three months ended March 31, 2005 from 26.5% for the same period last year. Our operating margin increased because revenues grew faster than operating expenses. Certain expenses such as office expense, salaries expense, network expense, and other fixed costs have increased at a slower rate than our revenues have.

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.

Reach

The following table sets forth the number of subscribers of each of our e-mail publications as of March 31, 2005 and 2004 and the total number of page views for selected sections of the *Travelzoo* Web site for the three months ended March 31, 2005 and 2004. Management considers the *Travelzoo* homepage 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.

	March 31,		Year-over-Year Growth
	2005	2004	
Subscribers:			
<i>Travelzoo Top 20</i>	8,200,000	6,855,000	19%
<i>Newsflash</i>	4,926,000	3,503,000	41%
	Three Months Ended March 31,		Year-over-Year Growth
	2005	2004	
Page views of selected sections of <i>Travelzoo</i> Web site:			
Homepage	10,663,000	7,430,000	44%
Front pages of destination categories	16,613,000	15,726,000	6%

Management believes that the increase in reach of its publications in the three months ended March 31, 2005 was in line with its strategy. The Company's revenues for the three months ended March 31, 2005 increased by 74% from the same period last year. The number of subscribers of the *Travelzoo Top 20* e-mail newsletter increased by 19%. Page views of selected sections of the *Travelzoo* Web site increased by 44% and 6% as shown in the table above. In the three months ended March 31, 2004, 91% of revenues were generated from the *Travelzoo* Web site and the *Travelzoo Top 20* newsletter. In the three months ended March 31, 2005, 71% of revenues were generated from the *Travelzoo* Web site and the *Travelzoo Top 20* newsletter. Management believes that the data for the three months ended March 31, 2005 and 2004 indicate that the Company was able to generate higher revenues as reach increased.

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Revenues

Our total revenues increased to \$11.2 million for the three months ended March 31, 2005 from \$6.5 million for the three months ended March 31, 2004. This represents an increase of 74%.

68% of our revenue growth in the three months ended March 31, 2005 compared to the three months ended March 31, 2004 came from our new product, *SuperSearch*. The remaining 32% came from our existing products (i.e. *Travelzoo* Web site, *Travelzoo Top 20* newsletter, 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 20% of the revenue growth in the period ended March 31, 2005 compared to the three months ended March 31, 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 12% of our revenue growth in the period ended March 31, 2005 compared to the three months ended March 31, 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 three months ended March 31, 2005, two clients accounted each for 10% or more of our total revenues. Click Here, Inc., an advertising agency representing Travelocity.com, accounted for 18% of our revenues. Orbitz, LLC accounted for 12% of our revenues. In the three months ended March 31, 2004, none of our clients accounted for 10% or more 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 \$864,000 for the three months ended March 31, 2005 from \$615,000 for the three months ended March 31, 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 remained the same, \$179,000, for the three months ended March 31, 2005 and the three months ended March 31, 2004. As a percentage of revenue, cost of revenues decreased to 2%, for the three months ended March 31, 2005 from 3% for the three months ended March 31, 2004. The decrease was due to an 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, public relations expenses, conference expenses, and salary expenses associated with sales and marketing staff. Sales and marketing expenses increased to \$5.0 million for the three months ended March 31, 2005 from \$3.5 million for the three months ended March 31, 2004. The increase in sales and marketing expenses was primarily due to increases of our advertising campaigns. The goal of our advertising campaigns is to acquire new subscribers for our e-mail products and to increase brand awareness for *Travelzoo*. For the three months ended March 31, 2005 and 2004, advertising expenses accounted for 74% 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 three months ended March 31, 2005 compared to the three months ended March 31, 2004 was also due to an increase in headcount of our sales force from eight employees to ten employees.

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Our goal is to increase our revenues from advertising sales. One important factor that drives our revenues are 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. 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 \$2.6 million for the three months ended March 31, 2005 from \$1.1 million for the three months ended March 31, 2004. In 2005, general and administrative expenses increased primarily due to expenses of \$984,000 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 three months ended March 31, 2005, the Company recorded expenses of \$984,000 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 \$210,000 in compliance costs in the three months ended March 31, 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 that 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 that the operations of Travelzoo UK will 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 quarter of 2005, an analysis of our average cost for acquisition of new subscribers for our *Travelzoo Top 20* newsletter 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.

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- **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.

Period	Average Cost per Acquisition of a New Subscriber	New Subscribers	Unsubscribes	Balance
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

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 March 31, 2005, we recorded an income tax provision of \$1.7 million. For the three months ended March 31, 2004, we recorded an income tax provision of \$707,000. 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. Our effective tax rate for 2005 increased from 2004 because of the expenses related to the program to make cash payments to former stockholders were treated as non tax deductible expenses for financial statement reporting purposes. The effective tax rate for interim periods in 2005 is based on our estimated annual effective tax rate for 2005 of 48.7%.

We expect that our effective tax rate in future periods may fluctuate depending on changes in estimates for the total amount of expenses from payments to former stockholders.

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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 director of the Company upon the exercise of fully vested options. The options were granted in 2001 to this director for their service as director in 2000 and 2001.

Liquidity and Capital Resources

As of March 31, 2005, we had \$39.6 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 three months ended March 31, 2005 was \$3.2 million. Net cash used in operating activities in the three months ended March 31, 2004 was \$88,000. In the three months ended March 31, 2005, net cash provided by operating activities resulted primarily from net income and an increase in income tax 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. The decrease in income tax payable was primarily due to estimated payments on current federal and state income tax liabilities. In the three months ended March 31, 2004, net cash used in operating activities resulted primarily from an increase in accounts receivable and a net decrease in income tax payable.

Net cash used in investing activities was \$42,000 and \$9,000 during the three months ended March 31, 2005 and March 31, 2004, respectively. In both periods, net cash was used in investing activities for equipment purchases.

Net cash used in financing activities was \$89,000 during the three months ended March 31, 2005. There were no cash flows related to financing activities in the three months ended March 31, 2004. In the three months ended March 31, 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.

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 \$2.2 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 March 31, 2005 (in thousands):

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	2005	2006	2007	2008	Thereafter	Total
Operating leases	\$ 822	110	—	—	—	\$ 932
Purchase obligations	18	—	—	—	—	18
Total commitments	\$ 840	110	—	—	—	\$ 950

As of March 31, 2005, we have recorded a liability of \$162,000 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 site ;
- 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 Limited, 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:

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- 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 maintenance and development of our strategic relationships;
- 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 site;
- 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 have each represented a substantial portion of our business in the three months ended March 31, 2005. Click Here, Inc., an advertising agency representing Travelocity.com, accounted for 18% of our revenue. Orbitz, LLC accounted for 12% of our revenue. The loss of one client or both clients 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. A copy of the agreement with Orbitz is filed as an exhibit to this Report. Copies of the agreements with Click Here were previously filed as exhibits to our Annual Report on Form 10-K for the year ended December 31, 2004.

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.

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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 business. 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.

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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 March 31, 2005, we had 52 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.

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.

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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 quarter of 2005, the sale prices of our common stock on the NASDAQ National Market ranged from \$41.54 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;

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- 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 recent 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 \$984,000 million for these cash payments for the three months ended March 31, 2005 of which \$162,000 remains as a liability as of March 31, 2005. The liability is based on the number of actual requests received from former stockholders through March 31, 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 4,087,000 shares had not submitted claims under the program as of March 31, 2005.

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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. Currently, none of our identified areas that need improvement have been categorized as material weaknesses or significant deficiencies. However, we are 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. 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 is 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. While we have a trademark for “Travelzoo,” many companies in the industry have similar names including the word “travel”. We expect that infringement claims in our markets will increase in number as more participants enter the markets. 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. Beginning in May 2005, we will be exposed to foreign currency risk associated with agreements being denominated in British Sterling Pounds and Euros. We will be 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 March 31, 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 March 31, 2005.

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During the quarter ended March 31, 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 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	Agreement with Orbitz, LLC dated August 4, 2004*
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

SIGNATURES

Pursuant to the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, State of New York, on May 13, 2005.

TRAVELZOO INC.
(Registrant)

By: /s/ RALPH BARTEL
Ralph Bartel
*Chairman of the Board, Chief Executive
Officer, and Chief Financial Officer*

By: /s/ LISA SU
Lisa Su
Controller (Chief Accounting Officer)



Travelzoo Inc.
590 Madison Avenue, 21st Floor
New York, NY 10022

Fax number for Insertion orders (650) 943-2433

INSERTION ORDER

Insertion Order #:	10690	Date:	8/4/2004
Advertiser:	Orbitz, LLC		
Contact Information:	Mike Stein Orbitz, LLC 200 South Wacker Drive Suite 1900 Chicago, IL 60606 Phone: (312) 894-4748 Fax: (413) 513-2141 mstein@orbitz.com	Bill To:	Orbitz, LLC Attn: Accounts Payable 200 South Wacker Drive Suite 1900 Chicago, IL 60606
Sales Contact:	Holger Bartel Phone: (650) 943-2411 hbartel@travelzoo-inc.com	Producer:	Steve Clarke Phone: (650) 943-2419 sclarke@travelzoo-inc.com

Advertising Program

Flight Dates: 8/1/2004 — 7/31/2005

Placements:

* clicks from SuperSearch
* clicks from Travelzoo sites and/or email products (eg., Top 20, Newsflash) (August 2004 through January 2005)
* clicks from Travelzoo sites and/or email products (eg., Top 20, Newsflash) (February 2005 through July 2005)

Fee:

\$*
\$*
\$*
\$*

TOTAL MAXIMUM NET INVESTMENT

Notes:

This is a cost-per-click agreement. Travelzoo will invoice Advertiser on the last day of each month during the term of this agreement for click-throughs actually delivered. Standard Billing terms: Net 30 days from receipt of invoice (with approved credit).

This is a cost-per-click agreement. Travelzoo will invoice Advertiser for clicks actually delivered.

Clicks from SuperSearch are invoiced at \$* per click, and estimated clicks are * — * clicks per month during 2004, and * — * per month during 2005. Advertiser may change the cost-per-click for SuperSearch on the first day of each month; however a 3-day advance notice is required to do so.

Clicks from all other advertisements on Travelzoo, including text and/or graphic ads (e.g. buttons) will be invoiced at \$* per click. Clicks are estimated at * — * per month for August 2004 through January 2005; and at * per month for February 2005 through July 2005.

Advertiser understands that actual clicks each month may be either below or above estimated clicks as set forth above. Advertiser will pay for actual clicks delivered each month, provided that total payments during the term of this agreement shall not exceed \$*.

Terms and Conditions for Insertion Order #10690
Orbitz Advertising with Travelzoo from August 1, 2004 through July 31, 2005

The following terms and conditions (the "General Terms") shall be deemed to be incorporated into insertion order/advertising agreement #10690 (the "Insertion Order"):

1. **Terms of Payment.** This is a pay-per-click agreement, and Advertiser will be billed only for click-throughs actually delivered. Travelzoo will invoice Advertiser on the last day of each month during the term of this agreement for click-throughs actually delivered, as set forth in the Insertion Order; provided, however that the total payments during the term of this agreement shall not exceed \$*. Payment shall be made to Travelzoo within thirty (30) days from the date of receipt of invoice ("Due Date"). Amounts paid after the Due Date shall bear interest at the rate of one percent (1%) per month (or the highest rate permitted by law, if less). In the event Advertiser fails to make timely payment, Advertiser will be responsible for all reasonable expenses (including attorneys' fees) incurred by Travelzoo in collecting such amounts. Travelzoo reserves the right to suspend performance of its obligations hereunder (or under any other agreement with Advertiser) in the event Advertiser fails to make timely payment hereunder or under any other agreement with Travelzoo,
2. **Positioning.** Except as otherwise expressly provided in the Insertion Order, positioning of advertisements on Travelzoo is at the sole discretion of Travelzoo. Travelzoo may, at its sole discretion, remove from the Insertion Order (and substitute with similar inventory) any keyword or category page that it believes to be a trademark, trade name, company name, product name or brand name belonging to or claimed by a third party.
3. **Usage Statistics.** Unless specified in the Insertion Order, Travelzoo makes no guarantees with respect to usage statistics or levels of impressions for any advertisement. Advertiser acknowledges that delivery statistics provided by Travelzoo are the official, definitive measurements of Travelzoo's performance on any delivery obligations provided in the Insertion Order. The processes and technology used to generate such statistics can be audited by the advertiser or an independent agency. Click-throughs will also be tracked and reported by Advertiser's third party ad server, and Travelzoo will be given access to all third party numbers continuously throughout the length of this agreement. In the event there is a discrepancy of greater than 5% between the click-throughs reported by Travelzoo and the click-throughs reported by advertiser's third party ad server for any month ("Discrepancy"), Advertiser's payment obligation shall be reduced by an amount equal to the Discrepancy (provided that Advertiser shall provide documentation of such Discrepancy with its payment).
4. **Renewal.** Except as expressly set forth in the Insertion Order, any renewal of the Insertion Order and acceptance of any additional advertising order shall be upon mutual agreement only, and acceptance of any additional advertising order shall be at Travelzoo's sole discretion. Pricing for any renewal period is subject to change by Travelzoo from time to time prior to the commencement of such renewal period.
5. **No Assignment or Resale of Ad Space.** Neither party shall resell, assign, or transfer any of its rights hereunder without the prior approval of the other party, and any attempt to resell, assign or transfer such rights without such approval shall result in immediate termination of this contract, without liability to the terminating party.
6. **Limitation of Liability.** In the event (1) Travelzoo fails to publish an advertisement in accordance with the schedule provided in the Insertion Order, (2) Travelzoo fails to deliver the number of total page views specified in the Insertion Order (if any) by the end of the specified period, or (3) of any other failure, technical or otherwise, of such advertisements to appear as provided in the Insertion order, the sole liability of Travelzoo to Advertiser shall be limited to, at Travelzoo's sole discretion, a pro rata refund of the advertising fee representing undelivered page views, placement of the advertisement at a later time in a comparable position, or extension of the term of the Insertion Order until total page views are delivered. In no event shall Travelzoo be responsible for any consequential, special, punitive or other damages, including, without limitation, lost revenue or profits, in any way arising out of or related to the Insertion Order/General Terms or publication of the advertisement, even if Travelzoo has been advised of the possibility of such damages. Without limiting the foregoing, Travelzoo shall have no liability for any failure or delay resulting from any governmental action, fire, flood, insurrection, earthquake, power failure, riot, explosion, embargo, strikes whether legal or illegal, labor material shortage, transportation interruption of any kind, work slowdown or any other condition beyond the control of Travelzoo affecting production or delivery in any manner. Except for each party's indemnification obligations hereunder, in no event shall either party's liability exceed the total amount paid by advertiser hereunder.
7. **Advertisers Representations; Indemnification.** Travelzoo shall use commercially reasonable efforts to ensure the advertisements are not placed in any context that harms the goodwill or reputation of Advertiser or that disparages or brings Advertiser into disrepute. Including, but not limited to web sites that contain indecent, illegal, misleading, harmful, abusive, harassing, libelous, defamatory, or other offensive materials. If Advertiser requests that its advertisements be removed from or not placed in any such context, Travelzoo will use commercially reasonable efforts to comply with such request promptly. Advertiser agrees, at its own expense, to indemnify, defend, and hold harmless Travelzoo and its employees, representatives, agents and affiliates, against any and all expenses and losses of any kind (including reasonable attorneys' fees and costs) incurred by Travelzoo in connection with any third-party claims, administrative proceedings or criminal investigations of any kind arising out of the content of the advertisement and/or any material, product or service of

Advertiser to which users can link through the advertisement (including, without limitation, any claim of trademark or copyright infringement, defamation, breach of confidentiality, privacy violation, false or deceptive advertising or sales practices).). Travelzoo agrees, at its own expense, to indemnify, defend, and hold harmless Advertiser and its employees, representatives, agents and affiliates, against any and all expenses and losses of any kind (including reasonable attorneys' fees and costs) incurred by Advertiser in connection with any third-party claims, administrative proceedings or criminal investigations of any kind arising out: (a) of any content, material, product or service available on a Travelzoo property that was not provided by or obtained from Advertiser (including, without limitation, any claim of

Travelzoo Inc. 590 Madison Avenue, 21st Floor, New York, NY 10022
Fax number for insertion orders (650) 943-2433

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trademark or copyright infringement, defamation, breach of confidentiality, privacy violation, false or deceptive advertising or sales practices), or (b) Travelzoo's breach of any duty, representation, or warranty under this agreement. All indemnities provided by Advertiser under this agreement are conditioned on the following: (a) Advertiser shall have sole control over the defense of any claim covered by the indemnity; (b) Travelzoo shall promptly report the existence of any claim or potential claim covered by the indemnity; (c) Travelzoo shall provide full and reasonable cooperation with Advertiser's investigation and defense of such claim; and (d) Travelzoo shall not materially alter any advertising material supplied to it by Advertiser or on its behalf. All indemnities provided by Travelzoo under this agreement are conditioned on the following: (a) Travelzoo shall have sole control over the defense of any claim covered by the indemnity; (b) Advertiser shall promptly report the existence of any claim or potential claim covered by the indemnity; and (c) Advertiser shall provide full and reasonable cooperation with Travelzoo's investigation and defense of such claim.

8. **Provision of Advertising Materials.** Advertiser will provide all materials for the advertisement in accordance with Travelzoo's policies in effect from time to time, including (without limitation) the manner of transmission to Travelzoo and the lead-time prior to publication of the advertisement. Ads cannot link to pages that include pop-up or pop-under windows. Travelzoo shall not be required to publish any advertisement that is not received in accordance with such policies and reserves the right to charge Advertiser, at the rate specified in the Insertion Order, for inventory held by Travelzoo pending receipt of acceptable materials from Advertiser which are past due. Advertiser hereby grants to Travelzoo a non-exclusive, worldwide, fully paid license to use, reproduce and display the advertisement (and the contents, trademarks and brand features contained therein) in accordance herewith.
9. **Right to Reject Advertisement.** All contents of advertisements are subject to Travelzoo's approval. Travelzoo reserves the right to reject or cancel any advertisement, insertion order, URL link, space reservation or position commitment, at any time, for any reason whatsoever (including belief by Travelzoo that placement of advertisement, URL link, etc., may subject Travelzoo to criminal or civil liability).
10. **Cancellations and Termination.** Either party may terminate this Insertion Order on ninety (90) days prior written notice.—In the event that either party breaches the terms of his agreement and fails to cure such breach within fifteen (15) days of receiving notice of such breach, the non-breaching party will have the right to terminate this agreement immediately without any further liability to the breaching party; provided however, that payments due prior to such termination shall remain payable in accordance with Section 1 hereof, except as otherwise provided in the Insertion Order, the Insertion Order is non-cancelable by Advertiser. All notices shall be in writing and shall be deemed delivered when delivered in person or mailed certified through the United States Postal Service, postage prepaid, or via FedEx addressed as follows: Travelzoo Inc., Attn: Contracts Department, 800 West El Camino Real, Suite 180, Mountain View, CA 94040; and Orbitz, LLC, Attention: Mike Stein, 200 S. Wacker Drive, Suite 1900, Chicago, IL 60606.
11. **Construction.** No conditions other than those set forth in the Insertion Order or these General Terms shall be binding on Travelzoo unless expressly agreed to in writing by Travelzoo. In the event of any inconsistency between the Insertion Order and the General Terms, the General Terms shall control.
12. **Miscellaneous.** These General Terms, together with the Insertion Order, (1) shall be governed by and construed in accordance with, the law of the State of New York, without giving effect to principles of conflicts of law; (2) may be amended only by a written agreement executed by an authorized representative of each party; and (3) constitute the complete and entire expression of the agreement between the parties, and shall supersede any and all other agreements, whether written or oral, between the parties. Neither party shall make any public announcement regarding the existence or content of the Insertion Order without the other party's written approval. Both parties consent to the jurisdiction of the courts of the State of New York with respect to any legal proceeding arising in connection with the Insertion Order/General Terms. All notices shall be in writing and shall be deemed delivered when delivered in person or mailed certified through the United States Postal Service, postage prepaid, or via FedEx addressed as follows: Travelzoo Inc., Attn: Contracts Department, 800 West El Camino Real, Suite 180, Mountain View, CA 94040.
13. **Third Party Ad Serving.** If Travelzoo has approved the use by Advertiser of a third party ad server (Third Party Ad Server) in connection with this Insertion Order, the following provisions shall also apply:
 - (1) The Advertiser shall post each advertisement to a staging area and shall notify Travelzoo of such posting at least four (4) business days prior to the date on which Third Party Ad Server is scheduled to serve such advertisement to a Travelzoo property. Such advertisement shall be reviewed by Travelzoo and must be approved in writing by Travelzoo before it can be served by Third Party Ad Server. In accordance with Section 9, Travelzoo reserves the right to reject any advertisement or any element thereof, for any reason at its sole discretion.
 - (2) The Advertiser shall post all scheduling changes, new target URLs, new HTML specifications, new graphics and all other new or revised advertisements ("Revisions") to a staging area and shall notify Travelzoo of such postings at least four (4) days prior to the date Advertiser wishes such Revisions to take effect. Revisions shall not be implemented until approved by Travelzoo in writing, which



approval shall be at Travelzoo's sole discretion.

(3) If Advertiser discovers that Advertiser or Third Party Server has served, or caused to be served, an advertisement to a Travelzoo property in violation of this Agreement, Advertiser must immediately provide notice to Travelzoo of the violation (along with a written explanation) and remove the advertisement from its placement or rotation to the Travelzoo properties. Nothing in this Section shall limit any of Travelzoo's rights or remedies in the event of such breach.

(4) In the event Travelzoo exercises its right to cancel an advertisement in accordance with Section 9 hereof, Travelzoo shall notify Advertiser in writing. The Advertiser must cause the advertisement to be removed from the Travelzoo properties and from its advertising rotation no later than four (4) hours after written notification by Travelzoo.

14. Domestic Traffic. Travelzoo acknowledges that Advertiser may sell travel services to customers located in the United States of America only. Travelzoo will use commercially reasonable efforts to display advertisements on web pages directed at U.S. customers and will in no event display advertisements on web pages directed primarily at non-U.S. residents. Advertiser may, at its own expense and within a period of 90 days following the advertising in a certain month, conduct an audit of clicks delivered to Advertiser. In the event that such audit determines that during the audited period the number of click-throughs from users originating from outside the U.S. (as indicated by a non-U.S. domain or IPS, or other indicia showing non-U.S. origin) (the "Non-US Click-Throughs") are 5% or more of the total number of click-throughs during the audited period (the "Total Click-Throughs"), then Travelzoo shall promptly refund to Advertiser any amounts paid by Advertiser associated with the number of Non-US Click-Throughs in excess of 5% of the Total Click-Throughs. By way of illustration, in the event that the number of Non-US Click-Throughs is 6.5% of the Total Click-Throughs, then the amount refunded by Travelzoo shall be the amounts paid by Advertiser associated with 1.5% of the Total Click-Throughs.

I hereby agree to the foregoing advertising program and the Terms and Conditions set forth above. All parties acknowledge that this Insertion Order and the Terms & Conditions above represent the entire agreement between Advertiser and Travelzoo. The undersigned confirms that he/she is authorized to execute this agreement on behalf of the Advertiser.

	For Advertiser:	For Travelzoo:
Authorized Signature:	/s/John Samuel	/s/Ralph Bartel
Date:	September 27, 2004	September 29, 2004
Name:	John Samuel	Ralph Bartel
Title:	EVP	CEO
Company:	Orbitz	Travelzoo Inc.

