

TRAVELZOO INC  
Form 10-Q  
August 09, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2010**

**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)*

**36-4415727**

*(I.R.S. employer  
identification no.)*

**590 Madison Avenue, 37th Floor  
New York, New York**

*(Address of principal executive offices)*

**10022**

*(Zip code)*

Registrant's telephone number, including area code: **(212) 484-4900**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if a smaller  
reporting company)

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

The number of shares of Travelzoo common stock outstanding as of August 5, 2010 was 16,443,828 shares.



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**TRAVELZOO INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(In thousands, except par value)**

|   | <b>June 30,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|---|--------------------------|----------------------------------|
| <b>ASSETS</b>   |                          |                                  |
| Current assets:   |                          |                                  |
| Cash and cash equivalents   | \$ 31,875                | \$ 19,776                        |
| Accounts receivable, less allowance for doubtful accounts of \$415 and \$501 as of June 30, 2010 and December 31, 2009, respectively      | 13,551                   | 11,279                           |
| Income tax receivable   | 797                      | 6,061                            |
| Deposits  | 192                      | 139                              |
| Prepaid expenses and other current assets   | 1,103                    | 1,103                            |
| Deferred tax assets   | 966                      | 966                              |
| <br>  |                          |                                  |
| Total current assets  | 48,484                   | 39,324                           |
| Deposits, less current portion  | 300                      | 381                              |
| Deferred tax assets, less current portion   | 52                       | 52                               |
| Restricted cash   | 875                      | 875                              |
| Property and equipment, net   | 3,949                    | 4,089                            |
| Intangible assets, net  | 1,234                    | 1,411                            |
| <br>  |                          |                                  |
| Total assets  | \$ 54,894                | \$ 46,132                        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                          |                                  |
| Current liabilities:  |                          |                                  |
| Accounts payable  | \$ 6,341                 | \$ 6,834                         |
| Accrued expenses  | 5,803                    | 4,278                            |
| Deferred revenue  | 1,029                    | 828                              |
| Income tax payable  | 352                      |                                  |
| Deferred rent   | 205                      | 134                              |
| <br>  |                          |                                  |
| Total current liabilities   | 13,730                   | 12,074                           |
| <br>  |                          |                                  |
| Deferred tax liabilities long-term  | 533                      | 533                              |
| Long-term tax liabilities   | 2,167                    | 2,139                            |
| Deferred rent, less current portion   | 579                      | 615                              |
| Commitments and contingencies   |                          |                                  |
| Stockholders equity:  |                          |                                  |
| Preferred stock, \$0.01 par value per share (5,000 shares authorized; none issued)  |                          |                                  |
| Common stock, \$0.01 par value (40,000 shares authorized; 16,444 shares issued and outstanding as of June 30, 2010 and December 31, 2009) | 164                      | 164                              |
| Additional paid-in capital  | 6,223                    | 4,772                            |
| Retained earnings   | 32,729                   | 27,008                           |

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|  |           |           |
|--|-----------|-----------|
| Accumulated other comprehensive loss       | (1,231)   | (1,173)   |
| Total stockholders' equity                 | 37,885    | 30,771    |
| Total liabilities and stockholders' equity | \$ 54,894 | \$ 46,132 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**TRAVELZOO INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

|  | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|--|--------------------------------|-------------|------------------------------|-------------|
|  | <b>30,</b>                     |             | <b>30,</b>                   |             |
|  | <b>2010</b>                    | <b>2009</b> | <b>2010</b>                  | <b>2009</b> |
| Revenues   | \$ 28,106                      | \$ 23,638   | \$ 56,624                    | \$ 46,618   |
| Cost of revenues   | 1,616                          | 1,458       | 3,270                        | 2,675       |
| Gross profit   | 26,490                         | 22,180      | 53,354                       | 43,943      |
| Operating expenses:  |                                |             |                              |             |
| Sales and marketing  | 14,049                         | 12,599      | 29,041                       | 24,013      |
| General and administrative                                   | 6,505                          | 6,211       | 13,217                       | 12,026      |
| Total operating expenses                                     | 20,554                         | 18,810      | 42,258                       | 36,039      |
| Operating income from continuing operations                  | 5,936                          | 3,370       | 11,096                       | 7,904       |
| Other income and expense:                                    |                                |             |                              |             |
| Interest income and other income                             | 45                             | 13          | 87                           | 32          |
| Loss on foreign currency                                     |                                | (116)       | (209)                        | (304)       |
| Income from continuing operations before income taxes        | 5,981                          | 3,267       | 10,974                       | 7,632       |
| Income taxes   | 2,734                          | 1,659       | 5,253                        | 3,984       |
| Income from continuing operations, net of tax                | 3,247                          | 1,608       | 5,721                        | 3,648       |
| Loss from discontinued operations, net of tax                |                                | (1,799)     |                              | (3,502)     |
| Net income (loss)  | \$ 3,247                       | \$ (191)    | \$ 5,721                     | \$ 146      |
| Basic net income (loss) per share from:                      |                                |             |                              |             |
| Continuing operations  | \$ 0.20                        | \$ 0.10     | \$ 0.35                      | \$ 0.22     |
| Discontinued operations                                      | \$                             | \$ (0.11)   | \$                           | \$ (0.21)   |
| Net income (loss) per share                                  | \$ 0.20                        | \$ (0.01)   | \$ 0.35                      | \$ 0.01     |
| Diluted net income (loss) per share from:                    |                                |             |                              |             |
| Continuing operations  | \$ 0.20                        | \$ 0.10     | \$ 0.35                      | \$ 0.22     |
| Discontinued operations                                      | \$                             | \$ (0.11)   | \$                           | \$ (0.21)   |
| Net income (loss) per share                                  | \$ 0.20                        | \$ (0.01)   | \$ 0.35                      | \$ 0.01     |
| Shares used in computing basic net income (loss) per share   | 16,444                         | 16,444      | 16,444                       | 16,372      |
| Shares used in computing diluted net income (loss) per share | 16,453                         | 16,452      | 16,452                       | 16,379      |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|   | <b>Six Months Ended June 30,</b> |             |
|---|----------------------------------|-------------|
|   | <b>2010</b>                      | <b>2009</b> |
| <b>Cash flows from operating activities:</b>                                      |                                  |             |
| Net income  | \$ 5,721                         | \$ 146      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |             |
| Depreciation and amortization   | 1,147                            | 926         |
| Stock-based compensation  | 375                              |             |
| Provision for losses on accounts receivable                                       | (1)                              | 316         |
| Net foreign currency effect   | 209                              | 317         |
| Changes in operating assets and liabilities:                                      |                                  |             |
| Accounts receivable   | (2,568)                          | (983)       |
| Deposits  | (85)                             | (24)        |
| Income tax receivable   | 5,264                            |             |
| Prepaid expenses and other current assets   | (40)                             | 1,636       |
| Accounts payable  | (269)                            | 2,029       |
| Accrued expenses  | 1,657                            | (369)       |
| Deferred revenue  | 220                              | 105         |
| Deferred rent   | 34                               | (102)       |
| Income tax payable  | 357                              | (1,945)     |
| Other non-current liabilities   | 28                               | 19          |
| Net cash provided by operating activities   | 12,049                           | 2,071       |
| <b>Cash flows from investing activities:</b>                                      |                                  |             |
| Purchases of property and equipment   | (751)                            | (1,204)     |
| Purchases of intangible assets  |                                  | (1,760)     |
| Net cash used in investing activities   | (751)                            | (2,964)     |
| <b>Cash flows from financing activities:</b>                                      |                                  |             |
| Proceeds from exercise of stock options   |                                  | 2,158       |
| Proceeds from sale of Asia Pacific business segment                               | 1,073                            |             |
| Net cash provided by financing activities   | 1,073                            | 2,158       |
| Effect of exchange rate changes on cash and cash equivalents                      | (272)                            | 100         |
| Net increase in cash and cash equivalents   | 12,099                           | 1,365       |
| Cash and cash equivalents at beginning of period                                  | 19,776                           | 14,179      |
| Cash and cash equivalents at end of period  | \$ 31,875                        | \$ 15,544   |
| Supplemental disclosure of cash flow information:                                 |                                  |             |
| Cash paid (received) for income taxes, net  | \$ (368)                         | \$ 4,179    |



See accompanying notes to unaudited condensed consolidated financial statements.

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**TRAVELZOO INC.**

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

**Note 1: The Company and Basis of Presentation**

Travelzoo Inc. (the Company or Travelzoo ) is a global Internet media company. We inform over 21 million subscribers worldwide, as well as millions of Web site users, about the best travel and entertainment deals available from thousands of companies. We publish these offers by sourcing, researching, test-booking, and selecting offers professionally. We provide airlines, hotels, cruise lines, vacation packagers, and other travel and entertainment companies with a fast, flexible, and cost effective way to reach millions of consumers. Our revenues are generated from advertising fees. Our publications and products include the *Travelzoo* Web sites (www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, the *Newsflash* e-mail alert service, the *SuperSearch* pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list travel deals published by Travelzoo. We also operate *Fly.com*, a travel search engine that allows users to quickly and easily find the best prices on flights from hundreds of airlines and online travel agencies.

Starting November 1, 2009, the Travelzoo Web sites in Asia Pacific (cn.travelzoo.com, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, among others), the Travelzoo Top 20 e-mail newsletters in Asia Pacific and the Newsflash e-mail alert service in Asia Pacific are published by Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly owned subsidiaries of Azzurro Capital Inc., under a license agreement with the Company.

Travelzoo is controlled by Ralph Bartel, who held beneficially approximately 66.3% of the outstanding shares as of August 1, 2010.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures 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, 2009, included in the Company's Form 10-K filed with the SEC on March 16, 2010.

The condensed 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. All foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated into U.S. dollars at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the period.

The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or any other future period, and the Company makes no representations related thereto.

Certain prior period amounts have been reclassified to conform to current year presentation. Specifically, as described in Note 15, *Discontinued Operations* , the Company has classified the financial results of its Asia Pacific operating segment as discontinued operations for all periods presented due to the sale of the assets of its Asia Pacific subsidiaries, which constituted the Company's Asia Pacific operating segment, to Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly-owned subsidiaries of Azzurro Capital Inc. The notes to the Company's unaudited condensed consolidated financial statements relate to continuing operations only, unless otherwise indicated.

The Company was formed as a result of a combination and merger of entities founded by the Company's majority stockholder, Ralph Bartel. In 1998, Mr. Bartel founded Travelzoo.com Corporation, a Bahamas corporation, which

issued 5,155,874 shares via the Internet to approximately 700,000 Netsurfer stockholders for no cash consideration. In 1998, Mr. Bartel also founded Silicon Channels Corporation, a California corporation, to operate the *Travelzoo* Web site. During 2001, Travelzoo Inc. was formed as a

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subsidiary of Travelzoo.com Corporation, and Mr. Bartel contributed all of the outstanding shares of Silicon Channels Corporation 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. Mr. Bartel exercised these options in January 2009.

During January 2001, the Board of Directors of Travelzoo.com Corporation proposed that Travelzoo.com Corporation be merged with Travelzoo Inc. whereby Travelzoo Inc. would be the surviving entity. On March 15, 2002, the stockholders of Travelzoo.com Corporation approved the merger with Travelzoo Inc. On April 25, 2002, the certificate of merger was filed in Delaware upon which the merger became effective and Travelzoo.com Corporation ceased to exist. Each outstanding share of common stock of Travelzoo.com Corporation was converted into the right to receive one share of common stock of Travelzoo Inc. Under and subject to the terms of the merger agreement, stockholders were allowed a period of two years following the effective date of the merger to receive shares of Travelzoo Inc. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation, and no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect this reduction of the number of shares reported as outstanding. As of June 30, 2010, there were 16,443,828 shares of common stock outstanding.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency, and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada, and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,068,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$6,000 for these cash payments for the six months ended June 30, 2010. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company's common stock price. The Company's common stock price affects the liability because the amount of cash payments under the program is based

in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding an additional approximately 4,068,000 shares had not submitted claims under the program as of June 30, 2010.

**Note 2: Revenue Recognition**

All revenue consists of advertising sales. Advertising revenues are principally derived from the sale of advertising in North America and Europe on the *Travelzoo* Web site, in the *Travelzoo Top 20* e-mail newsletter, in *Newsflash*, from *SuperSearch*, from the *Travelzoo Network*, and from *Fly.com*.

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The Company recognizes revenues in accordance with the Securities and Exchange Commission Staff Accounting Bulletin for 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, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are recognized upon delivery. 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, which represents stand-alone sales prices, for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed, number of clicks delivered, or number of referrals generated during the period.

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

*Evidence of an arrangement.* The Company considers an insertion order signed by the client or its agency to be evidence of an arrangement.

*Delivery.* Delivery is considered to occur when the advertising has been displayed and, if applicable, the click-throughs have been delivered.

*Fixed or determinable fee.* The Company considers the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

*Collection is deemed reasonably assured.* 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.

Insertion orders that include fixed-fee advertising are invoiced upon acceptance of the insertion order and on the first day of each month over the term of the insertion order, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are primarily 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.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

**Note 3: Recent Accounting Standards**

In June 2009, the FASB issued a new accounting standard that changes the consolidation model for variable interest entities. The new accounting standard requires a company to perform qualitative analysis when determining whether it must consolidate a variable interest entity and ongoing reassessments to determine if a company must consolidate a variable interest entity. The new accounting standard also requires a company to provide additional disclosures about the nature of restrictions on a consolidated variable interest entity's assets, its involvement with variable interest entities, any significant changes in risk exposure due to that involvement and how its involvement with a variable interest entity affects the company's financial statements. A company will also be required to disclose any significant judgments and assumptions made in determining whether it must consolidate a variable interest entity. Effective January 1, 2010, the Company adopted this new accounting standard. The adoption of this new accounting

standard did not have an impact on the Company's consolidated results of operations or financial condition.

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In October 2009, the FASB issued ASU 2009-13, a new accounting standard update for revenue recognition with multiple deliverables. The new accounting standard update defines when individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The update primarily provides two significant changes: 1) it eliminates the need for objective and reliable evidence of the fair value for the undelivered element in order for a delivered item to be treated as a separate unit of accounting, and 2) it eliminates the residual method to allocate the arrangement consideration. In addition, the update also expands the disclosure requirements for revenue recognition. The new accounting standard update will be effective for the Company January 1, 2011, with early adoption permitted. The Company is currently assessing the future impact of this new accounting standard on its consolidated results of operations and financial condition.

**Note 4: Financial Instruments**

At June 30, 2010, restricted cash consisted of a certificate of deposit for \$875,000 serving as collateral for a standby letter of credit for the security deposit of our corporate headquarters. Cash equivalents consist of highly liquid investments with remaining maturities of three months or less on the date of purchase held in money market funds. The Company believes that the carrying amounts of these financial assets are a reasonable estimate of their fair value. The fair value of these financial assets was determined using the following inputs at June 30, 2010 (in thousands):

|                    | Total     | Fair Value Measurements at Reporting Date Using Quoted Prices |   |   |
|--------------------|-----------|---|---|---|
|                    |           | in Active Markets for Identical Assets (Level 1)              | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets:            |           |   |   |   |
| Money market funds | \$ 27,301 | \$ 27,301   | \$  | \$  |
| Total              | \$ 27,301 | \$ 27,301   | \$  | \$  |

**Note 5: Internal-Use Software and Web Site Development**

The Company includes in fixed assets the capitalized cost of internal-use software and Web site development, including software used to upgrade and enhance its Web site and processes supporting the Company's business. Costs incurred in the planning stage and operating stage are expensed as incurred while costs incurred in the application development stage and infrastructure development stage are capitalized, assuming such costs are deemed to be recoverable.

As of June 30, 2010 and December 31, 2009, our capitalized internal-use software and Web site development costs, net of accumulated amortization, were \$685,000 and \$905,000, respectively. For the three months ended June 30, 2010 and 2009, the Company recorded amortization of capitalized internal-use software and Web site development costs of \$110,000 for each period. For the six months ended June 30, 2010 and 2009, the Company recorded amortization of capitalized internal-use software and Web site development costs of \$220,000 and \$189,000, respectively.

**Note 6: Intangible Assets**

Intangible assets consist of the following (in thousands):

|                               | June 30, 2010 | December 31, 2009 |
|-------------------------------|---------------|-------------------|
| Internet domain names         | \$ 2,117      | \$ 2,117          |
| Less accumulated amortization | 883           | 706               |



|       |          |          |
|-------|----------|----------|
| Total | \$ 1,234 | \$ 1,411 |
|-------|----------|----------|

Intangible assets have a useful life of 5 years. Amortization expense was \$88,000 and \$90,000 for the three months ended June 30, 2010 and 2009, respectively and \$177,000 and \$180,000 for the six months ended June 30, 2010 and 2009, respectively

Future expected amortization expense related to intangible assets at June 30, 2010 is as follows (in thousands):

|      |          |
|------|----------|
| 2010 | 177      |
| 2011 | 354      |
| 2012 | 352      |
| 2013 | 351      |
|      | \$ 1,234 |

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The expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, impairment of intangible assets, accelerated amortization of intangible assets and other events.

**Note 7: Certain Risks and Uncertainties**

The Company's cash, cash equivalents and accounts receivable are potentially subject to concentration of credit risk. Cash and cash equivalents are placed with financial institutions that management believes are of high credit quality. The accounts receivable are derived from revenue earned from customers located in the U.S. and internationally.

The Company maintains an allowance for doubtful accounts based upon its historical experience, the age of the receivable and customer specific information. Determining appropriate allowances for these losses is an inherently uncertain process, and ultimate losses may vary from the current estimates. The allowance for doubtful accounts was \$415,000 and \$501,000 at June 30, 2010 and December 31, 2009, respectively.

**Note 8: Stock-Based Compensation and Stock Options**

In October 2001, the Company granted to each director fully vested and exercisable options to purchase 30,000 shares of common stock with an exercise price of \$2.00 per share for their services as a director in 2000 and 2001. A total of 210,000 options were granted. The options expire in October 2011. 150,000 options were exercised during the year ended December 31, 2005, 17,275 options were exercised during the year ended December 31, 2006, and 30,000 options were exercised during the year ended December 31, 2008. As of June 30, 2010, 12,725 of these options are vested and remain outstanding.

In March 2002, the Company granted to each director options to purchase 5,000 shares of common stock with an exercise price of \$3.00 per share that vested in connection with their services as a director in 2002. A total of 35,000 options were granted. The options expire in March 2012. In October 2002, 1,411 options were cancelled upon the resignation of a director, 23,589 options were exercised during the year ended December 31, 2004 and 5,000 options were exercised during the year ended December 31, 2008. As of June 30, 2010, 5,000 of these options are vested and remain outstanding.

In November 2009, the Company granted to one of its employees options to purchase 300,000 shares of common stock with an exercise price of \$14.97. 75,000 options vest and become exercisable annually starting in July 1, 2011. The options expire in November 2019. As of June 30, 2010, none of the options were vested and 300,000 options were outstanding. Total stock-based compensation for three months and six months ended June 30, 2010 was \$187,000 and \$375,000, respectively. The Company did not record any stock-based compensation for three and six months ended June 30, 2009.

As of June 30, 2010, there was approximately \$3.0 million of unrecognized stock-based compensation expense related to outstanding stock options. This amount is expected to be recognized over 4.0 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these options will be different from our expectations.

**Note 9: Net Income Per Share**

Basic net income per share is computed using the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by adjusting the weighted-average number of common shares outstanding for the effect of dilutive potential common shares outstanding during the period. Potential common shares included in the diluted calculation consist of incremental shares issuable upon the exercise of outstanding stock options calculated using the treasury stock method.

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

|   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--|-------------|--------------------------------------|-------------|
|   | <b>2010</b>                            | <b>2009</b> | <b>2010</b>                          | <b>2009</b> |
| <b>Net income (loss):</b>                         |  |             |                                      |             |
| Net income from continuing operations, net of tax | \$ 3,247                               | \$ 1,608    | \$ 5,721                             | \$ 3,648    |
| Net loss from discontinued operations, net of tax |  | (1,799)     |                                      | (3,502)     |
| Net income (loss)                                 | \$ 3,247                               | \$ (191)    | \$ 5,721                             | \$ 146      |
| <b>Weighted average common shares</b>             | 16,444                                 | 16,444      | 16,444                               | 16,372      |
| <b>Diluted weighted average common shares</b>     | 16,453                                 | 16,452      | 16,452                               | 16,379      |
| <b>Basic net income (loss) per share from:</b>    |  |             |                                      |             |
| Continuing operations                             | \$ 0.20                                | \$ 0.10     | \$ 0.35                              | \$ 0.22     |
| Discontinued operations                           |  | (0.11)      |                                      | (0.21)      |
| Net income (loss)                                 | \$ 0.20                                | \$ (0.01)   | \$ 0.35                              | \$ 0.01     |
| <b>Diluted net income (loss) per share from:</b>  |  |             |                                      |             |
| Continuing operations                             | \$ 0.20                                | \$ 0.10     | \$ 0.35                              | \$ 0.22     |
| Discontinued operations                           |  | (0.11)      |                                      | (0.21)      |
| Net income (loss)                                 | \$ 0.20                                | \$ (0.01)   | \$ 0.35                              | \$ 0.01     |

For the six months ended June 30, 2010, options to purchase approximately 300,000 shares of common stock with exercise prices greater than the average fair value of the Company's stock were not included in the calculation because the effect would have been anti-dilutive.

**Note 10: Commitments and Contingencies**

The Company leases office space in Canada, France, Germany, Spain, the U.K., and the U.S. under operating leases which expire between July 31, 2010 and January 31, 2014. The future minimum lease payments under these operating leases as of June 30, 2010 total \$9.1 million. The future lease payments consist of \$2,005,000 due in 2010, \$2,948,000 due in 2011, \$2,033,000 due in 2012, \$1,924,000 due in 2013, and \$161,000 due in 2014.

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 being required to issue up to an additional approximately 4,068,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$6,000 for these cash payments for the three months ended June 30, 2010. 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 4,068,000 shares had not submitted claims under the program.

**Table of Contents****Note 11: Income Taxes**

In determining the quarterly provisions for income taxes, the Company uses an estimated annual effective tax rate which is based on our expected annual income and statutory tax rates in the U.S. The effective tax rate does not reflect any tax benefits from the losses of our foreign operations. For the six months ended June 30, 2010, our effective tax rate was 48%.

At June 30, 2010, the Company had approximately \$2.0 million in total unrecognized tax benefits. Unrecognized tax benefits of approximately \$793,000, which if recognized, would favorably affect the Company's effective income tax rate and unrecognized tax benefits of approximately \$1.2 million, if recognized, would be recorded in discontinued operations.

The Company's policy is to include interest and penalties related to unrecognized tax positions in income tax expense. As of June 30, 2010 and December 31, 2009, the Company had approximately \$164,000 and \$136,000, respectively, in accrued interest related to uncertain tax positions. The Company has not accrued any penalties related to our uncertain tax positions as we believe that it is more likely than not that there will not be any assessment of penalties.

The Company files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is no longer subject to U.S. federal and certain state tax examinations for years before 2005 and is no longer subject to California tax examinations for years before 2004. The Company is currently under examination by the Internal Revenue Service ( IRS ) for the 2005 and 2006 tax years. In January 2009, the IRS issued a Notice of Proposed Adjustment contesting the Company's tax deductions in 2005 and 2006 related to the program under which the Company made cash payments to people who established that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. On July 28, 2010, the Company reached a tentative settlement with the IRS with regards to the examination of the Company's 2005 and 2006 tax years, as a result of which, the Company would owe additional taxes of approximately \$544,000, including interest. The Company expects to pay this amount during the third quarter of 2010. The Company expects that the final settlement will result in a decrease in the Company's tax expense for the third quarter of 2010 of approximately \$160,000, due to the release of previously established tax liabilities and related interest of approximately \$704,000 for this matter.

**Note 12: Segment Reporting and Significant Customer Information**

The Company manages its business geographically and has two reportable operating segments: North America and Europe. North America consists of the Company's operations in Canada and the U.S. Europe consists of the Company's operations in France, Germany, Spain, and the U.K. The Company began operations in Europe in May 2005.

Management relies on an internal management reporting process that provides revenue and segment operating income (loss) for making financial decisions and allocating resources. Management believes that segment revenues and operating income (loss) are appropriate measures of evaluating the operational performance of the Company's segments.

The following is a summary of operating results from continuing operations and assets (in thousands) by business segment:

|  | <b>North<br/>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |
|--|--------------------------|---------------|--------------------|---------------------|
| <b>Three months ended June 30, 2010:</b> |                          |               |                    |                     |
| Revenues from unaffiliated customers     | \$ 22,153                | \$ 5,953      | \$                 | \$ 28,106           |
| Intersegment revenues                    | 42                       | 55            | (97)               |                     |
| Total net revenues                       | 22,195                   | 6,008         | (97)               | 28,106              |
| Operating income (loss)                  | 6,743                    | (808)         | 1                  | 5,936               |
| <b>Three months ended June 30, 2009:</b> | <b>North<br/>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |

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|                                      |           |          |       |           |
|--------------------------------------|-----------|----------|-------|-----------|
| Revenues from unaffiliated customers | \$ 19,637 | \$ 4,001 | \$    | \$ 23,638 |
| Intersegment revenues                | 99        | 21       | (120) |           |
| Total net revenues                   | 19,736    | 4,022    | (120) | 23,638    |
| Operating income (loss)              | 4,453     | (1,068)  | (15)  | 3,370     |

|  | <b>North</b>   |               |                    |                     |
|--|----------------|---------------|--------------------|---------------------|
|  | <b>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |
| <b>Six months ended June 30, 2010:</b> |                |               |                    |                     |
| Revenues from unaffiliated customers   | \$ 44,520      | \$ 12,104     | \$                 | \$ 56,624           |
| Intersegment revenues                  | 71             | 65            | (136)              |                     |
| Total net revenues                     | 44,591         | 12,169        | (136)              | 56,624              |
| Operating income (loss)                | 12,853         | (1,758)       | 1                  | 11,096              |

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|  | <b>North<br/>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |
|--|--------------------------|---------------|--------------------|---------------------|
| <b>Six months ended June 30, 2009:</b> |                          |               |                    |                     |
| Revenues from unaffiliated customers   | \$ 39,644                | \$ 6,974      | \$                 | \$ 46,618           |
| Intersegment revenues                  | 124                      | 26            | (150)              |                     |
| Total net revenues                     | 39,768                   | 7,000         | (150)              | 46,618              |
| Operating income (loss)                | 10,268                   | (2,344)       | (20)               | 7,904               |

|                             | <b>North<br/>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |
|-----------------------------|--------------------------|---------------|--------------------|---------------------|
| <b>As of June 30, 2010</b>  |                          |               |                    |                     |
| Property and equipment, net | \$ 3,795                 | \$ 154        | \$                 | \$ 3,949            |
| Total assets                | 74,688                   | 5,992         | (25,786)           | 54,894              |

|                                | <b>North<br/>America</b> | <b>Europe</b> | <b>Elimination</b> | <b>Consolidated</b> |
|--------------------------------|--------------------------|---------------|--------------------|---------------------|
| <b>As of December 31, 2009</b> |                          |               |                    |                     |
| Property and equipment, net    | \$ 3,908                 | \$ 181        | \$                 | \$ 4,089            |
| Total assets                   | 64,095                   | 4,960         | (22,923)           | 46,132              |

Revenue for each segment is recognized based on the customer location within a designated geographic region. Property and equipment are attributed to the geographic region in which the assets are located.

For the three and six months ended June 30, 2010 and 2009, the Company did not have any customers that accounted for 10% or more of revenue. As of June 30, 2010 and December 31, 2009, the Company did not have any customers that accounted for 10% or more of accounts receivable.

**Note 13: Comprehensive Income**

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to gains that under generally accepted accounting principles are recorded as an element of stockholders' equity but are excluded from net income. The Company's other comprehensive income is comprised of foreign currency translation adjustments.

The following are components of comprehensive income (in thousands):

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2010</b>                            | <b>2009</b> | <b>2010</b>                          | <b>2009</b> |
| Net income (loss)                        | \$ 3,247                               | \$ (191)    | \$ 5,721                             | \$ 146      |
| Other comprehensive income (loss):       |  |             |                                      |             |
| Foreign currency translation adjustments | \$ (184)                               | \$ 353      | \$ (58)                              | \$ 451      |
| Total comprehensive income (loss)        | \$ 3,063                               | \$ 162      | \$ 5,663                             | \$ 597      |

Accumulated other comprehensive loss, as reflected in the condensed consolidated balance sheets, consists of cumulative foreign currency translation adjustments.

**Note 14: Related Party Transaction**

On October 31, 2009, the Company completed the sale of its Asia Pacific operating segment to Azzurro Capital Inc. and its wholly owned subsidiaries, Travelzoo (Asia) Limited and Travelzoo Japan K.K. Azzurro Capital Inc. is owned and controlled by The Ralph Bartel 2005 Trust. Ralph Bartel, the Company's principal shareholder, is a Director of the Company and through June 30, 2010, was the Company's Chairman. Mr. Bartel is a member of the board of directors of Azzurro Capital Inc. and is currently the sole beneficiary of The Ralph Bartel 2005 Trust. The Company's receivables from Travelzoo (Asia) Limited and Travelzoo Japan K.K. totaled \$95,000 as of June 30, 2010.

and were related primarily to fees under the Hosting Agreement and Referral Agreement. The \$95,000 is part of prepaid expenses and other current assets in the accompanying condensed consolidated balance sheets. See Note 15 for a further discussion on the sale of the Company's Asia Pacific operating segment.



**Table of Contents****Note 15: Discontinued Operations**

On September 30, 2009, the Company and its principal Asia Pacific subsidiaries entered into two definitive Asset Purchase Agreements ( "Asset Purchase Agreements" ) with Azzurro Capital Inc., a company owned and controlled by The Ralph Bartel 2005 Trust, on behalf of itself, and Azzurro Capital Inc.'s newly formed wholly-owned subsidiaries, Travelzoo (Asia) Limited and Travelzoo Japan K.K., to acquire substantially all of the assets, and with the exception of intercompany loans, assume substantially all of the liabilities of Travelzoo's principal Asia Pacific subsidiaries, which constitute Travelzoo's Asia Pacific operating segment. The aggregate purchase price under the Asset Purchase Agreements was \$3,600,000, subject to a working capital adjustment, as defined in the Asset Purchase Agreements, based on unaudited balance sheets as of October 31, 2009. Ralph Bartel, the Company's principal shareholder, is a Director of the Company and through June 30, 2010, was the Company's Chairman. Mr. Bartel is a member of the board of directors of Azzurro Capital Inc. and is currently the sole beneficiary of The Ralph Bartel 2005 Trust.

As part of the transaction, the Company and Azzurro Capital Inc., Travelzoo (Asia) Limited and Travelzoo Japan K.K. entered into the following additional agreements:

A License Agreement providing for a limited, nontransferable (except as provided therein), perpetual, exclusive (except as provided therein) fully paid-up license to perform the Licensed Services and Licensed Business Processes (as defined in the License Agreements), and to use the Licensed Marks, the Licensed Software, the Licensed Trade Secrets, and the Licensed Works (as defined in the License Agreements) in connection with the Licensed Services and Licensed Business Processes within the Territory, which is defined as all countries located in those time zones that are more than five hours ahead of Greenwich Mean Time, based on Standard time, including India and Pakistan, but excluding Russia.

A Hosting Agreement under which Travelzoo agrees to host, transact, process, store, implement, operate, manage, maintain and provide access to licensed software and to data files and content provided by Travelzoo (Asia) Limited and Travelzoo Japan K.K. for use in connection with the Licensed Services and the Licensed Business Processes referred to in the Hosting Agreement.

A Referral Agreement pursuant to which each party will, on a non-exclusive basis, make customer referrals to each other, in consideration for receiving a specified percentage of the revenues derived from such referrals.

A Transition Services Agreement under which Travelzoo agrees to provide, at the option of the Travelzoo (Asia) Limited and Travelzoo Japan K.K., certain services on a temporary basis, at the prices and on other terms to be determined as provided in the Transition Services Agreement.

The Company and Azzurro Capital Inc. also entered into an Option Agreement (the "Option Agreement" ) on September 30, 2009, under which the Company will have an option (the "Option" ) to acquire the assets or shares of the Travelzoo (Asia) Limited and Travelzoo Japan K.K., exercisable during the month of June in any year from 2011 to 2020. The Option is also exercisable upon receipt by Travelzoo of a notice delivered under the Option Agreement of (a) the intent for either or both of the Travelzoo (Asia) Limited and Travelzoo Japan K.K. to cease operations or (b) an intention to effect an initial public offering of the shares of either of Travelzoo (Asia) Limited or Travelzoo Japan K.K. The purchase price under the Option will be the fair market value of the assets and business being acquired, determined by third party appraisal under the procedures set forth in the Option Agreement.

A voting agreement was also reached between the Company and Ralph Bartel with the intent to avoid any future conflicts of interest relating to the dealings between the Company and Azzurro Capital Inc. and their affiliates. Under the voting agreement, Mr. Bartel agrees to vote (or cause to be voted) any shares of the Company over which he has voting control, with respect to any proposal relating the Asia Pacific business, Azzurro Capital Inc., Travelzoo (Asia) Limited, or Travelzoo Japan K.K., in the same manner and in the same proportion that all other securities of the same class are voted at any meeting of the stockholders of the Company, and included provisions relating to the exercise of his voting rights as a shareholder or director of the Company in respect of matters between the Company and Azzurro Capital Inc. As a member of the Company's Board of Directors, Mr. Bartel also agrees to abstain from all deliberations and decisions of the Board of Directors with respect to any matters relating to any dealings, agreements or arrangements between the Company or any of its affiliates and Azzurro Capital Inc. or any of its affiliates, including with respect to the exercise of the Option, as mentioned above, except to the extent his vote shall be required to constitute a quorum or otherwise to permit the Board of Directors to take action, in which case he shall vote with the

majority of the other members of the Board of Directors (or shall abstain in the case of a tie).

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On October 31, 2009, the Company completed the sale of its Asia Pacific operating segment to Azzurro Capital Inc. pursuant to the terms of the Asset Purchase Agreements. The results of operations of the Asia Pacific operating segment have been classified as discontinued operations for all periods presented. The Company has not had significant ongoing involvement with the operations of the Asia Pacific operating segment and has not had material economic interests in the Asia Pacific operating segment since the completion of the sale. Accordingly, the sale of the Asia Pacific operating segment is treated as a discontinued operation under the relevant accounting literature.

At the completion of the sale, the Company received \$2.1 million, net of cash provided, and had a net receivable from Travelzoo (Asia) Limited and Travelzoo Japan K.K. of \$1.1 million, which was paid in March 2010. The Company realized a gain of \$3.4 million related to the sale of the net assets of the Asia Pacific business segment to Azzurro Capital Inc. The resulting gain on the sale was reflected as an addition to additional paid-in capital in the accompanying condensed consolidated balance sheets as both the Company and Azzurro Capital Inc. are under the common control of Ralph Bartel.

The following table presents the revenues and the components of loss from discontinued operations, net of tax (in thousands):

|   | <b>Three Months Ended June</b> |                 | <b>Six Months Ended June</b> |                 |
|---|--------------------------------|-----------------|------------------------------|-----------------|
|   | <b>2010</b>                    | <b>30, 2009</b> | <b>2010</b>                  | <b>30, 2009</b> |
| Revenues  | \$                             | \$ 642          | \$                           | \$ 1,030        |
| Cost of revenues                                      |                                | 54              |                              | 100             |
| Gross profit  |                                | 588             |                              | 930             |
| Operating expenses:                                   |                                |                 |                              |                 |
| Sales and marketing                                   |                                | 1,200           |                              | 2,123           |
| General and administrative                            |                                | 1,210           |                              | 2,342           |
| Total operating expenses                              |                                | 2,410           |                              | 4,465           |
| Operating loss from discontinued operations           |                                | (1,822)         |                              | (3,535)         |
| Other expense   |                                | (4)             |                              | (19)            |
| Loss from discontinued operations before income taxes |                                | (1,826)         |                              | (3,554)         |
| Income tax benefit                                    |                                | 27              |                              | 52              |
| Loss from discontinued operations, net of tax         | \$                             | \$ (1,799)      | \$                           | \$ (3,502)      |

**Table of Contents****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, in 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 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 for any reason, even if new information becomes available or other circumstances occur in the future.

**Overview**

Travelzoo Inc. (the Company, or Travelzoo) is a global Internet media company. We inform over 21 million subscribers worldwide, as well as millions of Web site users, about the best travel and entertainment deals available from thousands of companies. We publish these offers by sourcing, researching, test-booking, and selecting offers professionally. We provide airlines, hotels, cruise lines, vacation packagers, and other travel and entertainment companies with a fast, flexible, and cost-effective way to reach millions of consumers. Our revenues are generated from advertising fees.

Our publications and products include the *Travelzoo* Web sites (www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service. We operate *SuperSearch*, a pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list deals published by Travelzoo. We also operate *Fly.com*, a travel search engine that allows users to quickly and easily find the best prices on flights from hundreds of airlines and online travel agencies. More than 2,000 travel and entertainment companies use our services.

On October 31, 2009, we completed the sale of our Asia Pacific operating segment to Azzurro Capital Inc. and its wholly-owned subsidiaries, Travelzoo (Asia) Limited and Travelzoo Japan K.K. The results of operations of the Asia Pacific operating segment have been classified as discontinued operations for all periods presented. We have not had significant ongoing involvement with the operations of the Asia Pacific operating segment and have not had material economic interests in the Asia Pacific operating segment since the completion of the sale. Starting November 1, 2009, the *Travelzoo* Web sites in Asia Pacific (cn.travelzoo.com, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, among others), the *Travelzoo Top 20* e-mail newsletters in Asia Pacific and the *Newsflash* e-mail alert service in Asia Pacific are published by Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly owned subsidiaries of Azzurro Capital Inc., under a license agreement with the Company. See Note 15 to the accompanying condensed consolidated financial statements.

Our revenues are advertising revenues, consisting primarily of listing fees paid by travel and entertainment companies to advertise their offers on the *Travelzoo* Web sites, in the *Travelzoo Top 20* e-mail newsletter, in the *Newsflash* e-mail alert service, in *SuperSearch*, through the *Travelzoo Network*, and on *Fly.com*. Listing fees are based on placement, number of listings, number of impressions, number of click-throughs, or number of referrals. Insertion orders for listings are typically for periods between one month and twelve months and are not automatically renewed.

We have two operating segments based on geographic regions: North America and Europe. North America consists of our operations in Canada and the U.S. Europe consists of our operations in France, Germany, Spain, and the U.K. For the quarter ended June 30, 2010, European operations were 21% of revenues. Financial information with respect to our business segments and certain financial information about geographic areas appears in Note 12 to the accompanying consolidated financial statements.

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

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Growth in the number of subscribers to the Company's newsletters and page views of the homepages of the *Travelzoo* Web sites;  
 Operating margin;  
 Growth in revenues in the absolute and relative to the growth in reach of the Company's publications; and  
 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 the SEC Staff Accounting Bulletin for 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, which represents stand-alone sales prices, for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed, number of clicks delivered, or number of referrals generated during the period.

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

*Evidence of an arrangement.* 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 click-throughs 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 deemed reasonably assured.* 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.

Revenue from 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

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

Since the total cost of the program is not reliably estimable, the amount of expense recorded in a period is equal to the number of actual claims received during the period multiplied by (i) the number of shares held by each individual former stockholder and (ii) the applicable settlement price based on the recent price of our common stock at the date the claim is received as stipulated by the program. Requests are generally paid within 30 days of receipt. Please refer to Note 10 to our unaudited condensed consolidated financial statements for further details about our liabilities to former stockholders.

**Results of Operations**

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

|  | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | 2010                           | 2009   | 2010                         | 2009   |
| Revenues   | 100.0%                         | 100.0% | 100.0%                       | 100.0% |
| Cost of revenues                                       | 5.7                            | 6.2    | 5.8                          | 5.7    |
| Gross profit   | 94.3                           | 93.8   | 94.2                         | 94.3   |
| Operating expenses:                                    |                                |        |                              |        |
| Sales and marketing                                    | 50.0                           | 53.3   | 51.3                         | 51.5   |
| General and administrative                             | 23.1                           | 26.3   | 23.3                         | 25.8   |
| Total operating expenses                               | 73.1                           | 79.6   | 74.6                         | 77.3   |
| Operating income from continuing operations            | 21.2                           | 14.2   | 19.6                         | 17.0   |
| Other income and expenses, net                         | 0.1                            | (0.4)  | (0.2)                        | (0.6)  |
| Income from continuing operations, before income taxes | 21.3                           | 13.8   | 19.4                         | 16.4   |
| Income taxes   | 9.7                            | 7.0    | 9.3                          | 8.6    |
| Income from continuing operations                      | 11.6%                          | 6.8%   | 10.1%                        | 7.8%   |

For the three months ended June 30, 2010, we reported operating income from continuing operations of approximately \$5.9 million. Our operating margin from continuing operations increased to 21.2% for the three months ended June 30, 2010 compared to 14.2% for the same period last year. The main reason for the increase in operating

margin from continuing operations is our operating expenses as a percentage of revenues for the three months ended June 30, 2010 decreased compared to the three months ended June 30, 2009 (see Operating Expenses below).

For the six months ended June 30, 2010, we reported operating income from continuing operations of approximately \$11.1 million. Our operating margin increased to 19.6% for the six months ended June 30, 2010 compared to 17.0% for the same period last year. The main reason for the increase in operating margin from continuing operations is our general and administrative expenses as a percentage of revenues decreased for the six months ended June 30, 2010 compared to the six months ended June 30, 2009 (see Operating Expenses below).



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We do not know what our sales and marketing expenses as a percentage of revenues will be in future periods. Increased competition in our industry may require us to increase advertising for our brand and for our products. Increases in the average cost of acquiring new subscribers (see *Subscriber Acquisition* below) may result in an increase of sales and marketing expenses as a percentage of revenues. We may decide to accelerate our subscriber acquisition for various strategic and tactical reasons and, as a result, increase our marketing expenses. We may see a unique opportunity for a brand marketing campaign that will result in an increase of marketing expenses. Further, our strategy to replicate our business model in selected foreign markets (see *Growth Strategy* below) may result in a significant increase in our sales and marketing expenses and have a material adverse impact on our results of operations. We expect fluctuations of sales and marketing expenses as a percentage of revenues from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations.

We do not know what our general and administrative expenses as a percentage of revenues will be in future periods. There may be fluctuations that have a material impact on our results of operations. We expect our headcount to continue to increase in the future. The Company's headcount is one of the main drivers of general and administrative expenses. Therefore, we expect our absolute general and administrative expenses to continue to increase. In addition, we expect our expansion into foreign markets to result in a significant additional increase in our general and administrative expenses. Our general and administrative expenses as a percentage of revenues may also fluctuate depending on the number of requests received related to a program under which the Company intends to make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period.

**Reach**

The following table sets forth the number of subscribers of each of our e-mail publications in North America and Europe as of June 30, 2010 and 2009 and the total number of page views for the homepages of the *Travelzoo* Web sites in North America and Europe for the six months ended June 30, 2010 and 2009. Management considers the page views for the *Travelzoo* homepages 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 whether we are able to convert higher reach into higher revenues.

|   | <b>June 30,</b>                  |             | <b>Year-over-Year</b> |
|---|----------------------------------|-------------|-----------------------|
|   | <b>2010</b>                      | <b>2009</b> | <b>Change</b>         |
| <b>Subscribers:</b>   |                                  |             |                       |
| <b>North America</b>  |                                  |             |                       |
| <i>Travelzoo Top 20</i>                                       | 13,452,000                       | 11,812,000  | 14%                   |
| <i>Newsflash</i>  | 11,778,000                       | 9,923,000   | 19%                   |
| <b>Europe</b>   |                                  |             |                       |
| <i>Travelzoo Top 20</i>                                       | 4,137,000                        | 2,775,000   | 49%                   |
| <i>Newsflash</i>  | 4,064,000                        | 2,678,000   | 52%                   |
|   | <b>Six Months Ended June 30,</b> |             | <b>Year-over-Year</b> |
|   | <b>2010</b>                      | <b>2009</b> | <b>Change*</b>        |
| <b>Page views of homepages of <i>Travelzoo</i> Web sites:</b> |                                  |             |                       |
| <b>North America</b>  |                                  |             |                       |
|   | 20,611,000                       | 18,460,000  | 12%                   |
| <b>Europe</b>   |                                  |             |                       |
|   | 8,617,000                        | 6,185,000   | 39%                   |

\* The comparability of year-over-year changes of page views of the homepages of

*Travelzoo* Web sites may be limited due to the design and navigation of the Web sites.

In North America, revenues for the six months ended June 30, 2010 increased by 12% from the same period last year. The total number of subscribers in North America to the *Travelzoo Top 20* e-mail newsletter as of June 30, 2010 increased by 14% compared to June 30, 2009 and page views of the homepages of the *Travelzoo* Web sites in North America for the six months ended June 30, 2010 increased by 12% from the same period last year. In North America, we believe that revenue growth did not increase at the same level as the level of growth in subscribers to the *Travelzoo Top 20* e-mail newsletter and *Newsflash* e-mail alert service because we were unable to increase our advertising rates significantly due to intense competition in our industry.

In Europe, revenues for the six months ended June 30, 2010 increased by 74% from the same period last year. The total number of subscribers in Europe to the *Travelzoo Top 20* e-mail newsletter as of June 30, 2010 increased by 49% compared to June 30, 2009 and page views of the homepages of the *Travelzoo* Web sites in Europe increased by 39% from the same period last year. In Europe,

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revenues increased at a higher rate than the rate of growth in subscribers to the *Travelzoo Top 20* e-mail newsletter and the rate of growth in page views of the homepages of the *Travelzoo* Web sites in Europe due in part to increases in our advertising rates.

***Revenues***

Our total revenues increased to \$28.1 million for the three months ended June 30, 2010 from \$23.6 million for the three months ended June 30, 2009. This represents an increase of \$4.5 million or 19%. \$2.5 million of the increase in revenues came from our operations in North America, which had an increase of 12% in revenues year-over-year and was attributed primarily to a \$2.1 million increase in revenues from our publications, which includes the *Travelzoo* Web site, the *Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service and a \$366,000 increase in revenue from our search products, which consists of *SuperSearch* and *Fly.com*. \$2.0 million of the increase in revenues came from our operations in Europe, which had an increase of 49% in revenues year-over-year, and was attributed primarily to a \$1.7 million increase in revenue from our publications, which includes the *Travelzoo* Web site, the *Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service and a \$198,000 increase in revenue from our search products, which consists of *SuperSearch* and *Fly.com*. We launched *Fly.com* in Europe in October 2009. In local currency terms, revenues from our operations in Europe increased 55% year-over-year. The strengthening of the U.S. dollar relative to the British Pound Sterling and the Euro in the three months ended June 30, 2010 compared to the three months ended June 30, 2009 had an unfavorable impact on the revenues from our operations in Europe. Had foreign exchange rates remained constant in these periods, revenues from our operations in Europe for the three months ended June 30, 2010 would have been approximately \$296,000 higher than reported revenues of \$6.0 million.

Our total revenues increased to \$56.6 million for the six months ended June 30, 2010 from \$46.6 million for the six months ended June 30, 2009. This represents an increase of \$10.0 million or 21.5%. \$5.1 million of the increase in revenues came from our operations in Europe, which had an increase of 74% in revenues year-over-year, and was attributed primarily to a \$4.5 million increase in revenue from our publications, which includes the *Travelzoo* Web site, the *Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service and a \$636,000 increase in our search products, which consists of *SuperSearch* and *Fly.com*. We launched *Fly.com* in Europe in October 2009. In local currency terms, revenues from our operations in Europe increased 71% year-over-year. The weakening of the U.S. dollar relative to the British Pound Sterling and the Euro in the six months ended June 30, 2010 compared to the six months ended June 30, 2009 had a favorable impact on the revenues from our operations in Europe. Had foreign exchange rates remained constant in these periods, revenues from our operations in Europe for the six months ended June 30, 2010 would have been approximately \$138,000 lower than reported revenues of \$12.1 million. \$4.8 million of the increase in revenues came from our operations in North America and was attributed primarily to a \$4.3 million increase in revenues from our publications, which includes the *Travelzoo* Web site, the *Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service and a \$478,000 increase in revenue from our search products, which consists of *SuperSearch* and *Fly.com*.

For the three and six months ended June 30, 2010 and June 30, 2009, none of our customers accounted for 10% or more of our revenue.

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

- Our ability to increase our advertising rates;
- Our ability to sell more advertising to existing clients;
- Our ability to increase the number of clients;
- Our ability to develop new revenue streams; and
- Our ability to launch new products.

We believe that we can increase our advertising rates 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 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 have 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. We do not know if we will have market acceptance of our new products.



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Our goal is to increase our advertising rates at least once a year in each market, preferably as of January 1 of each year. We increased advertising rates on select listings in the U.S. on January 1, 2010 and we did not increase our advertising rates in the U.S. on January 1, 2009. We increased advertising rates on select listings in Europe on January 1, 2010, January 1, 2009 and April 15, 2009 due in part to the increase in the reach of our publications. In the U.S. and Europe, we were not able to increase advertising rates on all listings in 2010 due to intense competition in our industry. We intend to continue reviewing advertising rates and considering increases once a year as of January 1. However, there is no assurance that we will increase our advertising rates. Depending on the level of competition in the industry and the condition of the online advertising market, we may decide not to increase our advertising rates in all or certain markets.

Average annualized revenue per employee decreased to \$541,000 for the three months ended June 30, 2010 from \$543,000 for the three months ended June 30, 2009.

***Cost of Revenues***

Cost of revenues consists primarily of network expenses, including fees we pay for co-location services and depreciation and maintenance of network equipment, payments made to third-party partners of the *Travelzoo Network*, fees we pay related to user searches on *Fly.com*, amortization of capitalized Web site development costs, and salary expenses associated with network operations staff. Our cost of revenues increased to \$1.6 million for the three months ended June 30, 2010 from \$1.5 million for the three months ended June 30, 2009. As a percentage of revenue, cost of revenues decreased to 5.7% for the three months ended June 30, 2010 from 6.2% for the three months ended June 30, 2009. The \$158,000 increase in cost of revenues for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 was primarily due to a \$93,000 increase in fees we pay related to user searches on *Fly.com* and a \$72,000 increase in depreciation and maintenance costs.

Our cost of revenues increased to \$3.3 million for the six months ended June 30, 2010 from \$2.7 million for the six months ended June 30, 2009. As a percentage of revenue, cost of revenues increased to 5.8% for the six months ended June 30, 2010 from 5.7% for the six months ended June 30, 2009. The \$595,000 increase in cost of revenues for the six months ended June 30, 2010 compared to the six months ended June 30, 2009 was primarily due to a \$417,000 increase in fees we pay related to user searches on *Fly.com* and a \$184,000 increase in depreciation and maintenance costs.

***Operating Expenses******Sales and Marketing***

Sales and marketing expenses consist primarily of advertising and promotional expenses, salary expenses associated with sales, marketing and production staff, expenses related to our participation in industry conferences, and public relations expenses. Sales and marketing expenses increased to \$14.0 million for the three months ended June 30, 2010 from \$12.6 million for the three months ended June 30, 2009. The goal of our advertising was to acquire new subscribers for our e-mail products, increase the traffic to our Web sites, and increase brand awareness for *Travelzoo* and *Fly.com*. The \$1.4 million increase in sales and marketing expenses for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 was primarily due to a \$790,000 increase in salary and employee related expenses due in part to an increase in headcount and a \$566,000 increase in marketing expenses for *Fly.com*. For the three months ended June 30, 2010 and 2009, advertising expenses accounted for 61% and 63%, respectively, of total sales and marketing expenses.

Sales and marketing expenses increased to \$29.0 million for the six months ended June 30, 2010 from \$24.0 million for the six months ended June 30, 2009. The \$5.0 million increase in sales and marketing expenses for the six months ended June 30, 2010 compared to the six months ended June 30, 2009 was primarily due to a \$1.9 million increase in salary and employee related expenses due in part to an increase in headcount, a \$1.3 million increase in marketing expenses for *Fly.com*, a \$963,000 increase in advertising to acquire new subscribers for our e-mail products and a \$416,000 increase in advertising to acquire traffic to our Web sites. For the six months ended June 30, 2010 and 2009, advertising expenses accounted for 60% and 69%, respectively, of total sales and marketing expenses.

Our goal is to increase our revenues from advertising sales. One important factor that drives our revenues is our advertising rates. We believe that we can increase our advertising rates only if the reach of our publications increases.

In order to increase the reach of our publications, we have to acquire a significant number of new subscribers in every quarter and continue to promote our brand. One significant factor that impacts our advertising expenses is the average cost per acquisition of a new subscriber. We believe that the

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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 began operations in the U.K. In 2006, we began operations in Canada, Germany, and Spain. In 2007, we began operations in France. The continuing build-up of our business in Europe is expected to result in a relatively high level of sales and marketing expense in the foreseeable future.

*General and Administrative*

General and administrative expenses consist primarily of compensation for administrative, executive, and software development staff, fees for professional services, rent, bad debt expense, amortization of intangible assets, and general office expense. General and administrative expenses increased to \$6.5 million for the three months ended June 30, 2010 from \$6.2 million for the three months ended June 30, 2009. The \$294,000 increase in general and administrative expenses was primarily due to a \$110,000 increase in bank and merchant account fees and a \$110,000 increase in employee development expenses.

General and administrative expenses increased to \$13.2 million for the six months ended June 30, 2010 from \$12.0 million for the six months ended June 30, 2009. The \$1.2 million increase in general and administrative expenses was primarily due to a \$431,000 increase in salary and employee related expenses, a \$232,000 increase in professional services expense, a \$175,000 increase in bank and merchant account fees, and a \$172,000 increase in rent and office expense.

In the six months ended June 30, 2010 and 2009, the Company recorded expenses of \$6,000 and \$2,000, respectively, related to a program under which the Company makes cash payments to people 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 expenses are based on the number of actual valid claims received and the Company's stock price. We cannot reliably estimate future expenses incurred under this program because it is based on the number of valid requests received and future levels of the Company's common stock price.

We expect our headcount 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.

Our strategy to replicate our business model in foreign markets is expected to result in a significant additional increase in our general and administrative expenses in the foreseeable future.

**Subscriber Acquisition**

The table set forth below provides for each quarter in 2007, 2008, 2009, and the first two quarters of 2010, an analysis of our average cost for acquisition of new subscribers for our *Travelzoo Top 20* newsletter and our *Newsflash* e-mail alert service for our North America and Europe operating segments.

The table includes the following data:

**Average Cost per Acquisition of a New Subscriber:** The quarterly cost of consumer marketing programs whose purpose was primarily to acquire new subscribers, divided by total new subscribers added during the quarter.

**New Subscribers:** Total new subscribers who signed up for at least one of our e-mail publications throughout the quarter. This is an unduplicated subscriber number, meaning a subscriber who signed up for two or more of our publications is only counted once.

**Subscribers Removed From List:** Subscribers who were removed from our lists 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:** 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 subscribers removed from list during the current quarter.

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North America:

| Period  | Average Cost<br>per<br>Acquisition of<br>a<br>New |             | Subscribers |         | Balance    |
|---------|---|-------------|-------------|---------|------------|
|         | Subscriber  | Subscribers | New         | Removed |            |
|         |   |             | From List   |         |            |
| Q1 2007 | \$ 2.61   | 730,063     | (345,896)   |         | 10,611,505 |
| Q2 2007 | \$ 3.03   | 552,488     | (335,304)   |         | 10,828,689 |
| Q3 2007 | \$ 3.92   | 385,408     | (255,008)   |         | 10,959,089 |
| Q4 2007 | \$ 3.78   | 279,967     | (242,822)   |         | 10,996,234 |
| Q1 2008 | \$ 4.97   | 296,565     | (270,427)   |         | 11,022,372 |
| Q2 2008 | \$ 3.39   | 348,506     | (303,623)   |         | 11,067,255 |
| Q3 2008 | \$ 3.73   | 360,916     | (292,052)   |         | 11,136,119 |
| Q4 2008 | \$ 2.75   | 487,681     | (341,057)   |         | 11,282,743 |
| Q1 2009 | \$ 2.29   | 720,320     | (259,537)   |         | 11,743,526 |
| Q2 2009 | \$ 2.15   | 885,031     | (277,439)   |         | 12,351,118 |
| Q3 2009 | \$ 1.80   | 1,076,367   | (418,417)   |         | 13,009,068 |
| Q4 2009 | \$ 1.61   | 619,831     | (380,626)   |         | 13,248,273 |
| Q1 2010 | \$ 1.89   | 1,009,235   | (434,754)   |         | 13,822,754 |
| Q2 2010 | \$ 1.62   | 719,777     | (492,527)   |         | 14,050,004 |

Europe:

| Period  | Average Cost<br>per<br>Acquisition of<br>a<br>New |             | Subscribers |         | Balance   |
|---------|---|-------------|-------------|---------|-----------|
|         | Subscriber  | Subscribers | New         | Removed |           |
|         |   |             | From List   |         |           |
| Q1 2007 | \$ 3.89   | 159,439     | (31,350)    |         | 783,379   |
| Q2 2007 | \$ 4.43   | 206,003     | (39,690)    |         | 949,692   |
| Q3 2007 | \$ 2.96   | 331,903     | (32,689)    |         | 1,248,906 |
| Q4 2007 | \$ 5.85   | 165,781     | (33,357)    |         | 1,381,330 |
| Q1 2008 | \$ 3.90   | 362,417     | (45,152)    |         | 1,698,595 |
| Q2 2008 | \$ 4.89   | 226,156     | (31,055)    |         | 1,893,696 |
| Q3 2008 | \$ 4.52   | 253,961     | (38,418)    |         | 2,109,239 |
| Q4 2008 | \$ 3.32   | 160,172     | (46,736)    |         | 2,222,675 |
| Q1 2009 | \$ 3.09   | 295,450     | (40,542)    |         | 2,477,583 |
| Q2 2009 | \$ 2.74   | 408,026     | (52,491)    |         | 2,833,118 |
| Q3 2009 | \$ 3.53   | 541,509     | (99,396)    |         | 3,275,231 |
| Q4 2009 | \$ 3.97   | 443,280     | (117,519)   |         | 3,600,992 |
| Q1 2010 | \$ 3.65   | 478,518     | (117,617)   |         | 3,961,893 |
| Q2 2010 | \$ 4.31   | 400,549     | (116,273)   |         | 4,246,169 |

In North America, we noted a trend of decreasing average cost per acquisition of a new subscriber ( CPA ) in 2009 after a period of increasing CPA and a decrease in CPA in the second quarter of 2010 from the first quarter of 2010. We do not consider the decreases in CPA to be indicative of a longer-term trend or to indicate that our CPA is likely to stay at this level or is likely to decrease further.



In Europe, we see a large fluctuation in the CPA. The CPA fluctuates from quarter to quarter and from country to country. The decline in CPA in Europe in the fourth quarter of 2008 reflects the change in the exchange rates between the third quarter of 2008 and the fourth quarter of 2008 and accounted for \$0.51 of the decrease in the CPA.

Future increases in CPA are likely to result in 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 CPA over the long term. The effect on operations is that greater absolute and relative marketing expenditures may be necessary to continue to grow the reach of our publications. However, 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.

**Segment Information**

We have presented the business segments in this report based on our organizational structure as of June 30, 2010.

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|   | Three Months Ended June |           | Six Months Ended June |           |
|---|-------------------------|-----------|-----------------------|-----------|
|   | 30,                     |           | 30,                   |           |
|   | 2010                    | 2009      | 2010                  | 2009      |
|   | (In thousands)          |           | (In thousands)        |           |
| Net revenues                              | \$ 22,195               | \$ 19,736 | \$ 44,591             | \$ 39,768 |
| Income from operations                    | 6,743                   | 4,453     | 12,854                | 10,268    |
| Income from operations as a % of revenues | 30.4%                   | 22.6%     | 28.8%                 | 25.8%     |

In North America, revenues increased \$2.5 million, or 12%, for the three months ended June 30, 2010 compared to the same period in 2009 (see Revenues above). Sales and marketing expense decreased to \$9.5 million, or 43% of revenue, for the three months ended June 30, 2010 from \$9.6 million, or 49% of revenue, for the three months ended June 30, 2009. The \$78,000 decrease in sales and marketing expense was primarily due to a \$739,000 decrease in advertising to acquire new subscribers for our e-mail products, offset by a \$543,000 increase in salary and employee related expenses and a \$148,000 increase in marketing expenses for *Fly.com*. General and administrative expenses increased to \$4.6 million, or 21% of revenue, for the three months ended June 30, 2010 from \$4.3 million, or 22% of revenue, for the three months ended June 30, 2009. The \$273,000 increase in general and administrative expense was primarily due to a \$176,000 increase in salary and employee related expenses. Income from operations for North America as a percentage of revenue for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 increased to 30.4% from 22.6%.

In North America, revenues increased \$4.8 million, or 12%, for the six months ended June 30, 2010 compared to the same period in 2009 (see Revenues above). Sales and marketing expense increased to \$19.8 million, or 44% of revenue, for the six months ended June 30, 2010 from \$18.4 million, or 46% of revenue, for the six months ended June 30, 2009. The \$1.4 million increase in sales and marketing expense was primarily due to a \$1.0 million increase in salary and employee related expenses, an \$802,000 increase in marketing expenses for *Fly.com*, offset by a \$477,000 decrease in advertising to acquire new subscribers for our e-mail products. General and administrative expenses increased to \$9.2 million, or 21% of revenue, for the six months ended June 30, 2010 from \$8.6 million, or 22% of revenue, for the six months ended June 30, 2009. The \$594,000 increase in general and administrative expense was primarily due to a \$396,000 increase in salary and employee related expenses and a \$173,000 increase in bank and merchant account fees. Income from operations for North America as a percentage of revenue for the six months ended June 30, 2010 compared to the six months ended June 30, 2009 increased to 28.8% from 25.8%.

**Europe**

|   | Three Months Ended June |          | Six Months Ended June |          |
|---|-------------------------|----------|-----------------------|----------|
|   | 30,                     |          | 30,                   |          |
|   | 2010                    | 2009     | 2010                  | 2009     |
|   | (In thousands)          |          | (In thousands)        |          |
| Net revenues                            | \$ 6,008                | \$ 4,022 | \$ 12,169             | \$ 7,000 |
| Loss from operations                    | (808)                   | (1,068)  | (1,757)               | (2,344)  |
| Loss from operations as a % of revenues | 13.4%                   | 26.6%    | 14.4%                 | 33.5%    |

In Europe, revenues increased \$2.0 million, or 49%, for the three months ended June 30, 2010 compared to the same period in 2009 (see Revenues above). Sales and marketing expenses increased to \$4.5 million, or 75% of revenue, for the three months ended June 30, 2010 from \$3.0 million, or 75% of revenue, for the three months ended June 30, 2009. The \$1.5 million increase in sales and marketing expense was primarily due to a \$606,000 increase in advertising to acquire new subscribers for our e-mail products, a \$418,000 increase in marketing expenses for *Fly.com*, a \$247,000 increase in salary and employee related expenses due primarily to an increase in headcount, and a \$224,000 increase in advertising to acquire traffic to our Web sites. General and administrative expenses remained unchanged at \$2.0 million, or 33% of revenue, for the three months ended June 30, 2010 compared to \$2.0 million, or 49% of revenue, for the three months ended June 30, 2009. Our loss from operations in Europe was \$808,000 for the

three months ended June 30, 2010 compared to a loss of \$1.1 million for the three months ended June 30, 2009. The strengthening of the U.S. dollar relative to the British Pound Sterling and the Euro in the three months ended June 30, 2010 compared to the three months ended June 30, 2009 had a favorable impact on the loss from our operations in Europe. Had foreign exchange rates remained constant in these periods, the loss from our operations in Europe for the three months ended June 30, 2010 would have been approximately \$58,000 higher.

In Europe, revenues increased \$12.2 million, or 74%, for the six months ended June 30, 2010 compared to the same period in 2009 (see Revenues above). Sales and marketing expenses increased to \$9.3 million, or 76% of revenue, for the six months ended June 30, 2010 from \$5.6 million, or 80% of revenue, for the six months ended June 30, 2009. The \$3.6 million increase in sales and marketing expense was primarily due to a \$1.4 million increase in advertising to acquire new subscribers for our e-mail products, an

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\$850,000 increase in salary and employee related expenses due primarily to an increase in headcount, a \$573,000 increase in advertising to acquire traffic to our Web sites and a \$504,000 increase in marketing expenses for *Fly.com*. General and administrative expenses increased to \$4.1 million, or 34% of revenue, for the six months ended June 30, 2010 from \$3.5 million, or 50% of revenue, for the six months ended June 30, 2009. The \$605,000 increase in general and administrative expense was primarily due to a \$313,000 increase in professional services expenses and a \$172,000 increase in rent and office expense. Our loss from operations in Europe was \$1.8 million for the six months ended June 30, 2010 compared to a loss of \$2.3 million for the six months ended June 30, 2009.

**Income Taxes**

Our income is generally taxed in the U.S. and our income tax provisions reflect federal and state statutory rates applicable to our levels of income and expenses, adjusted to take into account expenses that are treated as having no recognizable tax benefit. We recorded income tax provisions of \$2.7 million and \$1.7 million relating to income from continuing operations for the three months ended June 30, 2010 and June 30, 2009, respectively. For the three months ended June 30, 2010 and 2009, our effective tax rates were 46% and 51%, respectively. Our effective tax rate decreased for the three months ended June 30, 2010 compared to 2009, due primarily to the decrease in losses from our Europe business segments which were treated as having no recognizable tax benefit.

We recorded income tax provisions of \$5.3 million and \$4.0 million relating to income from continuing operations for the six months ended June 30, 2010 and June 30, 2009, respectively. For the six months ended June 30, 2010 and 2009, our effective tax rates were 48% and 52%, respectively. Our effective tax rate decreased for the six months ended June 30, 2010 compared to 2009, due primarily to the decrease in losses from our Europe business segments which were treated as having no recognizable tax benefit.

We expect that our effective tax rate in future periods may fluctuate depending on the total amount of expenses representing payments to former stockholders, from losses or gains incurred by our operations in Canada and Europe and corresponding U.S. tax credits, if any.

In January 2009, the Internal Revenue Service ( IRS ) issued a Notice of Proposed Adjustment contesting the Company's tax deductions in 2005 and 2006 related to the program under which the Company made cash payments to people who established that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. On July 28, 2010, the Company reached a tentative settlement with the IRS with regards to the examination of the Company's 2005 and 2006 tax years, as a result of which, the Company would owe additional taxes of approximately \$544,000, including interest. The Company expects to pay this amount during the third quarter of 2010. The Company expects that the final settlement will result in a decrease in the Company's tax expense for the third quarter of 2010 of approximately \$160,000, due to the release of previously established tax liabilities and related interest of approximately \$704,000 for this matter.

**Discontinued Operations**

On October 31, 2009, we completed the sale of our Asia Pacific operating segment to Azzurro Capital Inc. and its wholly-owned subsidiaries, Travelzoo (Asia) Limited and Travelzoo Japan K.K. The results of operations of the Asia Pacific operating segment have been classified as discontinued operations for all periods presented. We received \$3.1 million, net of cash provided, of which \$2.1 was received at the completion of the sale in 2009 and the balance was received in March 2010. We realized a gain of \$3.4 million related to the sale of the net assets of the Asia Pacific business segment to Azzurro Capital Inc. which was reflected as an addition to additional paid-in capital as both the Company and Azzurro Capital Inc. are under the common control of Ralph Bartel. We recorded a tax benefit of \$4.4 million in discontinued operations for the tax benefit associated with the loss on investments in the Asia Pacific subsidiaries as a result of their dissolution.

**Liquidity and Capital Resources**

As of June 30, 2010, we had \$31.9 million in cash and cash equivalents. Cash and cash equivalents increased from \$19.8 million as of December 31, 2009 primarily as a result of cash provided by operating activities and financing activities as explained below. We expect that cash on hand will be sufficient to provide for working capital needs for at least the next 12 months.

**Six Months Ended June 30,**

|  | <b>2010</b>           | <b>2009</b> |
|--|-----------------------|-------------|
|  | <b>(In thousands)</b> |             |
| Net cash provided by operating activities                    | \$ 12,049             | \$ 2,071    |
| Net cash used in investing activities                        | (751)                 | (2,964)     |
| Net cash provided by financing activities                    | 1,073                 | 2,158       |
| Effect of exchange rate changes on cash and cash equivalents | (272)                 | 100         |
| Net increase in cash and cash equivalents                    | \$ 12,099             | \$ 1,365    |

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Cash provided by operating activities is net income adjusted for certain non-cash items and changes in assets and liabilities. Net cash provided by operating activities for the six months ended June 30, 2010 increased by \$10.0 million compared to the six months ended June 30, 2009. The \$10.0 million increase in cash provided by operating activities was due primarily to a \$5.6 million increase in net income and a \$5.3 million decrease in our income tax receivable as of June 30, 2010 compared to December 31, 2009.

Net cash used in investing activities was \$751,000 for the six months ended June 30, 2010 compared to \$3.0 million for the six months ended June 30, 2009. The \$2.2 million decrease in cash used in investing activities was due primarily to a \$453,000 decrease in purchases of property and equipment and we used \$1.8 million to purchase the fly.com domain name during the six months ended June 30, 2009.

Net cash provided by financing activities was \$1.1 million for the six months ended June 30, 2010. For the six months ended June 30, 2010, net cash provided by financing activities was due to proceeds received from sale of our Asia Pacific business segment. For the six months ended June 30, 2009, net cash provided by financing activities was due to the exercise of stock options.

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 the development of new products, cash payments to former stockholders of Travelzoo.com Corporation, expansion of our operations, and the amount of resources we devote to promoting awareness of the *Travelzoo* and *Fly.com* brands. Since the inception of the program under which we would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period, we have incurred expenses of \$2.7 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 valid requests ultimately received. Consistent with our growth, we have experienced substantial increases in our cost of revenues, sales and marketing expenses and our general and administrative expenses, and we anticipate that these increases will continue for the foreseeable future. We believe cash on hand 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 for at least the next 12 months, unanticipated events and opportunities or a less favorable than expected development of our business in Europe 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.

If the development of our business in Europe is less favorable than expected, we may decide to significantly reduce the size of our operations and marketing expenses in Europe with the objective of reducing cash outflow. For the six months ended June 30, 2010, cash used in operating activities in Europe was \$1.3 million.

The following summarizes our principal contractual commitments as of June 30, 2010 (in thousands):

|                      | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>Total</b> |
|----------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Operating leases     | \$ 2,005    | \$ 2,948    | \$ 2,033    | \$ 1,924    | \$ 161      | \$ 9,071     |
| Purchase obligations | 1,189       | 1,931       | 176         |             |             | 3,296        |
| Total commitments    | \$ 3,194    | \$ 4,879    | \$ 2,209    | \$ 1,924    | \$ 161      | \$ 12,367    |

We also have contingencies related to net unrecognized tax benefits of approximately \$2.0 million as of June 30, 2010. We expect to make a payment of approximately \$544,000 to the IRS and reduce our long-term tax liabilities by approximately \$160,000 in the third quarter of 2010 (see *Income Taxes* above). For the remaining balance of \$1.3 million, we are unable to make reasonably reliable estimates on the timing of the cash settlements with the

respective taxing authorities.

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### **Growth Strategy**

Our growth strategy has three main elements:

**International expansion:** We want to grow our revenue and operating profit through multiplying the Travelzoo business in attractive international markets in Europe and in North America. We want to develop a strong competitive position through building a strong global brand and unique global content.

**Expand scope of the *Travelzoo* business:** We want to grow our revenue and operating profit through expanding the Travelzoo product offerings and content into entertainment (e.g., Broadway shows, sporting events).

***Fly.com*:** We want to grow revenue and operating profits through building up *Fly.com*, our new meta-search engine for airfares. We have identified meta-search as an opportunity with attractive economics and great synergies with *Travelzoo*.

We launched the Travelzoo business in the U.K. in 2005, in Canada in 2006, in Germany in 2006, in France in 2007, and in Spain in 2008. We began developing and offering entertainment content and related advertising services in 2008. We launched *Fly.com* in February 2009.

### **Recent Accounting Standards**

In June 2009, the FASB issued a new accounting standard that changes the consolidation model for variable interest entities. The new accounting standard requires a company to perform qualitative analysis when determining whether it must consolidate a variable interest entity and ongoing reassessments to determine if a company must consolidate a variable interest entity. The new accounting standard also requires a company to provide additional disclosures about the nature of restrictions on a consolidated variable interest entity's assets, its involvement with variable interest entities, any significant changes in risk exposure due to that involvement and how its involvement with a variable interest entity affects the company's financial statements. A company will also be required to disclose any significant judgments and assumptions made in determining whether it must consolidate a variable interest entity. Effective January 1, 2010, we adopted this new accounting standard. The adoption of this new accounting standard did not have an impact on our consolidated results of operations or financial condition.

In October 2009, the FASB issued ASU 2009-13, a new accounting standard update for revenue recognition with multiple deliverables. The new accounting standard update defines when individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The update primarily provides two significant changes: 1) it eliminates the need for objective and reliable evidence of the fair value for the undelivered element in order for a delivered item to be treated as a separate unit of accounting, and 2) it eliminates the residual method to allocate the arrangement consideration. In addition, the update also expands the disclosure requirements for revenue recognition. The new accounting standard update will be effective for us January 1, 2011, with early adoption permitted. We are currently assessing the future impact of this new accounting standard on our consolidated results of operations and financial condition.

### **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**

***We cannot assure you that we will be profitable.***

For the three and six months ended June 30, 2010, we generated net income of \$3.2 million and \$5.7 million, respectively. In the year ended December 31, 2009, we generated a net income of \$5.2 million. Although we were profitable in 2009 and in the three and six months ended June 30, 2010, we incurred a net loss in 2008, and there is no assurance that we will continue to be profitable in the future. We forecast our future expense levels based on our operating plans and our estimates of future revenues. We may find it necessary to significantly accelerate expenditures relating to our sales and marketing efforts or otherwise increase our financial commitment to creating and maintaining



brand awareness among Internet users and travel companies. If our revenues grow at a slower

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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 be profitable. We expect our operations in Europe to incur losses through the end of 2010. Any of these developments could result in a significant decrease in the trading price of our common stock.

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

Our quarterly and annual 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 period. You should not rely on quarter-to-quarter comparisons of our results of operations as an indication of future performance. Factors that may affect our quarterly results include:

mismatches between resource allocation and client demand due to difficulties in predicting client demand in a new market;

changes in general economic conditions that could affect marketing efforts generally and online marketing efforts in particular;

the magnitude and timing of marketing initiatives, including our acquisition of new subscribers and our expansion efforts in other regions;

the introduction, development, timing, competitive pricing and market acceptance of our products and services and those of our competitors;

our ability to attract and retain key personnel;

our ability to manage our anticipated growth and expansion;

our ability to attract traffic to our Web sites;

technical difficulties or system downtime affecting the Internet generally or the operation of our products and services specifically;

payments which we may make to previous stockholders of Travelzoo.com Corporation who failed to submit requests for shares in Travelzoo Inc. within the required time period; and

volatility of our operating results in new markets.

We may significantly increase our operating expenses related to advertising campaigns for *Travelzoo* for a certain period if we see a unique opportunity for a brand marketing campaign, if we find it necessary to respond to increased brand marketing by a competitor, or if we decide to accelerate our acquisition of new subscribers.

If revenues fall below our expectations in any quarter and we are unable to quickly reduce our operating expenses in response, our operating results would be lower than expected and our stock price may fall.

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

Our current revenue model depends on advertising fees paid primarily by travel and entertainment 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 and entertainment 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.



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***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.***

For the six months ended June 30, 2010, our cash and cash equivalents increased by \$12.1 million to \$31.9 million. We intend to continue to grow our business, and intend to fund our current operations and anticipated growth from the cash on hand. However, this may not be sufficient to meet our needs. We may not be able to obtain financing on commercially reasonable terms, or at all.

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

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

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

The demand for online advertising may be linked to the level of economic activity and employment in the U.S. and abroad. Specifically, our business is primarily dependent on the demand for online advertising from travel and entertainment companies. The recent recession decreased consumer travel and caused travel and entertainment companies to reduce or postpone their marketing spending generally, and their online marketing spending in particular. Continued or future recessions could have a material adverse effect on our business and financial condition.

***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, unexpected technical problems in the systems that power our Web sites and distribute our e-mail newsletters, 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, which could result 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. Any such event could reduce our revenue and harm our operating results and financial condition. We do not carry business interruption insurance to compensate us for losses that may occur as a result of any of these events.

***Risks Related to Our Markets and Strategy***

***Our international expansion is expected to result in substantial operating losses, and is subject to other material risks.***

In May 2005, we began operations in the U.K. In 2006, we began operations in Canada, Germany, and Spain. In 2007, we began operations in France.

Although our revenues in Europe increased 74% in the six months ended June 30, 2010 from the same period last year, we expect our operations in Europe will continue to incur losses through the end of 2010 primarily as a result of significant expenses related to subscriber acquisition and the launch of *Fly.com*. We intend to continue adding a significant number of subscribers in selected countries in which we operate as we believe this is one of the factors that will allow us to increase our advertising rates and increase our revenues in Europe.

The losses from our operations in Europe may not have any recognizable tax benefit. We expect that this will have a material negative impact on our net income and cash flows. Any of these developments could result in a significant decrease in the trading price of our common stock. In addition to uncertainty about our ability to generate net income

from our foreign operations and expand our international market position, there are certain risks inherent in doing business internationally, including:

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trade barriers and changes in trade regulations;

difficulties in developing, staffing and simultaneously managing foreign operations as a result of distance, language and cultural differences;

stringent local labor laws and regulations;

currency exchange rate fluctuations;

risks related to government regulation; and

potentially adverse tax consequences.

***We may not be able to continue developing awareness of our brand names.***

We believe that continuing to build awareness of the *Travelzoo* and *Fly.com* brand names 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 U.S. in 2001 or the current global financial crisis 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 such 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 and entertainment 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 and entertainment companies and Internet users find attractive. This could reduce the number of travel and entertainment companies and Internet users using our products and materially adversely affect our business.

***We may lose business if we fail to keep pace with rapidly changing technologies and client 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 and entertainment 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, entertainment 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.

**Table of Contents*****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.***

Since the commencement of our operations, we have experienced a period of rapid growth. In order to execute our business plan, we must continue to grow significantly. As of June 30, 2010, we had 208 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 could otherwise have a material adverse effect on our business.

***Our operations may be adversely affected by changes in our senior management.***

On November 18, 2009, the Company entered into an employment agreement with Christopher Loughlin, the Company's former Executive Vice President, Europe, under which, effective July 1, 2010, Mr. Loughlin replaced Holger Bartel as Chief Executive Officer. Mr. Loughlin served as the Company's Vice President of Business Development from 2001 to 2005 and served as the Company's Senior Vice President and General Manager, Travelzoo U.K. from 2005 to 2006. From 2006 to June 30, 2010, Mr. Loughlin served as the Company's Executive Vice President, Europe, and has extensive familiarity with the business and operations of the Company. However, there can be no assurances that these changes in the senior management of the Company will not have an adverse effect on the business of the Company, temporarily or otherwise.

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

We face intense competition. We compete for advertising dollars with large Internet portal sites, such as America Online, MSN, and Yahoo!, that offer listings or other advertising opportunities for travel and entertainment companies. These companies have significantly greater financial, technical, marketing, and other resources and larger client bases. We compete with search engines like Google and Yahoo! Search that offer pay-per-click listings. We compete with travel meta-search engines and online travel deal publishers. We compete with large online travel agencies like Expedia and Priceline that also offer advertising placements. In addition, we compete with newspapers, magazines, and other traditional media companies that operate Web sites which 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, entertainment 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 Christopher Loughlin, our Chief Executive Officer. The loss or departure of any of our officers or key employees could materially adversely affect our ability to implement our business plan. We do not maintain key person life insurance for any member of our management team. In addition, we expect new members to join our management team in the future. These individuals will not previously have worked together and will be required to become integrated into our management team. If our key management personnel are not able to work together effectively or successfully, our business could be materially adversely affected.

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

We use technology and software products from third parties including Microsoft. Technology from our current or other vendors may not continue to be available to us on commercially reasonable terms, or at all. Our business will



suffer if we are unable to access this technology, to gain access to additional products or to integrate new technology with our existing systems. This could cause delays in our development and introduction of new services and related products or enhancements of existing products until equivalent

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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. 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 a Director of Travelzoo, is our largest stockholder, holding beneficially, as of August 1, 2010, approximately 66.3% of our outstanding shares. Through his share ownership, he is in a position to control Travelzoo and to elect our entire board of directors.

**Risks Related to Legal Uncertainty**

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

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

user privacy;

anti-spam legislation;

consumer protection;

copyright, trademark and patent infringement;

pricing controls;

characteristics and quality of products and services;

sales and other taxes; and

other claims based on the nature and content of Internet materials.

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

We may be sued for defamation, negligence, copyright or trademark infringement or other legal claims relating to information that is published or made available in our products. These types of claims have been brought, sometimes successfully, against online services in the past. 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

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interruptions or delays in e-mail service. In addition, we could incur significant costs in investigating and defending such claims, even if we ultimately are not liable. If any of these events occur, our business could be materially adversely affected.

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

The merger of Travelzoo.com Corporation into the Company became effective on April 25, 2002. Stockholders of Travelzoo.com Corporation were allowed a period of two years following the effective date to receive shares in the Company. 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 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, 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 4,068,000 shares of common stock for no additional payment, which would result in substantial dilution of the ownership interests of the other stockholders, and in 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 would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of \$6,000 for these cash payments for the six months ended June 30, 2010. 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 4,068,000 shares had not submitted claims under the program as of June 30, 2010.

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

We are obligated to evaluate our internal controls over financial reporting in order to allow management to report on, and our independent auditors to opine on, 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. In our 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 has been categorized as material weaknesses. 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

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rights. The steps we have taken to protect our proprietary rights, however, may not be adequate to deter misappropriation of proprietary information.

We have registered the *Travelzoo* trademark in the U.S., Australia, Canada, China, Hong Kong, Japan, South Korea, Taiwan, and the U.K. If we are unable to protect our rights in the mark in North America, Europe, and Asia Pacific, a key element of our strategy of promoting *Travelzoo* as a brand could be disrupted and our business could be adversely affected. We may not be able to detect unauthorized use of our proprietary information or take appropriate steps to enforce our intellectual property rights. In addition, the validity, enforceability, and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving. The laws of 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.

Our operations in Canada expose us to foreign currency risk associated with agreements being denominated in Canadian Dollars. Our operations in Europe expose us to foreign currency risk associated with agreements being denominated in British Pound Sterling and Euros. We are exposed to foreign currency risk associated with fluctuations of these currencies as the financial position and operating results of our operations in Canada and Europe will be translated into U.S. Dollars for consolidation purposes. We do not use derivative instruments to hedge these exposures. We are a net receiver of U.S. Dollars from our foreign subsidiaries and therefore benefit from a weaker U.S. dollar and are adversely affected by a stronger U.S. dollar relative to the foreign currency used by the foreign subsidiary as its functional currency. We have performed a sensitivity analysis as of June 30, 2010, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to the U.S. dollar with all other variables held constant. The foreign currency exchange rates we used were based on market rates in effect at June 30, 2010. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in an incremental \$89,000 foreign exchange loss for the three month and six month periods ended June 30, 2010.

**Item 4. Controls and Procedures**

For the period ended June 30, 2010, we carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) and 15d-15(e). Based upon that evaluation, the Company's Chief Executive Officer along with the Company's Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2010 to ensure that the information required to be disclosed by us in this quarterly report was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and were also effective to ensure that information required to be disclosed by us in this quarterly report was accumulated and communicated to our management including the Company's Chief Executive Officer and the Company's Chief

Financial Officer to allow timely decisions regarding its disclosure.

During the three months ended June 30, 2010, 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.

**Table of Contents****PART II OTHER INFORMATION****Item 1A. Risk Factors**

An updated description of the risk factors associated with our business is included under "Risk Factors" in Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in Item 2 of Part I of this report. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our 2009 Annual Report on Form 10-K and is incorporated herein by reference.

**Item 6. Exhibits**

The following table sets forth a list of exhibits:

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 3.1                       | Certificate of Incorporation of Travelzoo Inc. (Incorporated by reference to our Pre-Effective Amendment No. 6 to 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 Pre-Effective Amendment No. 6 to our Registration Statement on Form S-4 (File No. 333-55026), filed February 14, 2002).                      |
| 31.1                      | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.   |
| 31.2                      | Certification of 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 pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2                      | Certification of 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

Furnished  
herewith

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**SIGNATURE**

Pursuant to the requirements of 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.

TRAVELZOO INC.  
(Registrant)

By: /s/ Wayne Lee  
Wayne Lee  
*On behalf of the Registrant and as Chief Financial  
Officer  
and Principal Accounting Officer*

Date: August 9, 2010