

Expedia, Inc.  
Form 10-Q  
October 26, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from            to

Commission File Number: 000-51447

**EXPEDIA, INC.**

(Exact name of registrant as specified in its charter)

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

**20-2705720**  
(I.R.S. Employer  
Identification No.)

**333 108<sup>th</sup> Avenue NE**  
**Bellevue, WA 98004**

(Address of principal executive office) (Zip Code)

**(425) 679-7200**

(Registrant's telephone number, including area code)

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 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 ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

The number of shares outstanding of each of the registrant's classes of common stock as of October 12, 2012 was:

Common stock, \$0.0001 par value per share	122,068,153 shares
Class B common stock, \$0.0001 par value per share	12,799,999 shares

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**Expedia, Inc.**

**Form 10-Q**

**For the Quarter Ended September 30, 2012**

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**Table of Contents****Part I. Item 1. Consolidated Financial Statements****EXPEDIA, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except for per share data)

(Unaudited)

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Revenue	\$ 1,199,020	\$ 1,020,450	\$ 3,055,488	\$ 2,661,876
Costs and expenses:				
Cost of revenue (1)	243,633	206,451	673,472	577,871
Selling and marketing (1) (2)	505,756	408,169	1,327,401	1,159,560
Technology and content (1)	125,617	98,472	350,554	278,380
General and administrative (1)	85,140	78,680	246,936	221,885
Amortization of intangible assets	9,474	5,564	21,527	17,312
Legal reserves, occupancy tax and other	2,310	14,015	5,384	18,904
Operating income	227,090	209,099	430,214	387,964
Other income (expense):				
Interest income	7,759	5,784	20,574	14,570
Interest expense	(22,101)	(23,234)	(65,482)	(68,245)
Other, net	(8,410)	10,790	(19,277)	(1,796)
Total other expense, net	(22,752)	(6,660)	(64,185)	(55,471)
Income from continuing operations before income taxes	204,338	202,439	366,029	332,493
Provision for income taxes	(36,150)	(30,599)	(70,145)	(66,617)
Income from continuing operations	168,188	171,840	295,884	265,876
Discontinued operations, net of taxes	1,543	38,566	(22,346)	137,629
Net income	169,731	210,406	273,538	403,505
Net (income) loss attributable to noncontrolling interests	1,746	(872)	(101)	(1,539)
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 171,477</b>	<b>\$ 209,534</b>	<b>\$ 273,437</b>	<b>\$ 401,966</b>
<b>Amounts attributable to Expedia, Inc.:</b>				
Income from continuing operations	\$ 169,934	\$ 170,947	\$ 295,783	\$ 264,455
Discontinued operations, net of taxes	1,543	38,587	(22,346)	137,511
Net income	\$ 171,477	\$ 209,534	\$ 273,437	\$ 401,966
<b>Earnings per share from continuing operations attributable to Expedia, Inc. available to common stockholders:</b>				
Basic	\$ 1.25	\$ 1.26	\$ 2.21	\$ 1.94
Diluted	1.20	1.22	2.12	1.90
<b>Earnings per share attributable to Expedia, Inc. available to common stockholders:</b>				

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Basic	\$	1.26	\$	1.54	\$	2.04	\$	2.94
Diluted		1.21		1.50		1.96		2.89
<b>Shares used in computing earnings per share:</b>								
Basic		135,968		136,176		133,919		136,632
Diluted		141,423		139,684		139,650		139,271
Dividends declared per common share	\$	0.13	\$	0.14	\$	0.31	\$	0.42

(1) Includes stock-based compensation as follows:

Cost of revenue	\$	781	\$	584	\$	2,503	\$	1,975
Selling and marketing		2,881		2,423		10,574		8,211
Technology and content		3,957		2,982		12,115		9,535
General and administrative		7,719		7,034		23,718		19,613

(2) Includes related party amounts as follows:

	\$	57,258	\$	60,417	\$	164,339	\$	173,560
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*See accompanying notes.*

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**EXPEDIA, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income	\$ 169,731	\$ 210,406	\$ 273,538	\$ 403,505
Other comprehensive income (loss), net of tax				
Currency translation adjustments	14,910	(32,977)	3,535	2,613
Unrealized gains (losses) on available for sale securities, net of taxes	465	(1,369)	1,554	(418)
Other comprehensive income (loss), net of tax	15,375	(34,346)	5,089	2,195
Comprehensive income	185,106	176,060	278,627	405,700
Less: Comprehensive (income) loss attributable to noncontrolling interests	548	(2,953)	(424)	(8,750)
Comprehensive income attributable to Expedia, Inc.	\$ 185,654	\$ 173,107	\$ 278,203	\$ 396,950

*See accompanying notes.*

**Table of Contents****EXPEDIA, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

	<b>September 30, 2012 (Unaudited)</b>	<b>December 31, 2011</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,314,728	\$ 689,134
Restricted cash and cash equivalents	21,850	19,082
Short-term investments	1,042,324	648,819
Accounts receivable, net of allowance of \$10,095 and \$7,959	566,339	339,427
Prepaid expenses and other current assets	130,296	121,541
Current assets of discontinued operations	15,873	456,426
Total current assets	3,091,410	2,274,429
Property and equipment, net	393,454	320,282
Long-term investments and other assets	187,421	289,348
Intangible assets, net	828,318	743,898
Goodwill	3,006,962	2,877,301
<b>TOTAL ASSETS</b>	<b>\$ 7,507,565</b>	<b>\$ 6,505,258</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable, merchant	\$ 1,097,218	\$ 777,602
Accounts payable, other	311,610	173,855
Deferred merchant bookings	1,468,495	833,625
Deferred revenue	23,062	15,238
Accrued expenses and other current liabilities	398,194	333,237
Current liabilities of discontinued operations		419,800
Total current liabilities	3,298,579	2,553,357
Long-term debt	1,249,328	1,249,281
Deferred income taxes, net	353,233	279,962
Other long-term liabilities	134,116	117,491
Commitments and contingencies		
Stockholders' equity:		
Common stock \$.0001 par value	19	18
Authorized shares: 1,600,000		
Shares issued: 188,388 and 176,378		
Shares outstanding: 122,581 and 120,781		
Class B common stock \$.0001 par value	1	1
Authorized shares: 400,000		
Shares issued and outstanding: 12,800 and 12,800		
Additional paid-in capital	5,727,728	5,474,653
Treasury stock - Common stock, at cost	(2,901,255)	(2,535,219)
Shares: 65,806 and 55,597		
Retained earnings (deficit)	(448,802)	(722,239)
Accumulated other comprehensive loss	(12,584)	(17,350)

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Total Expedia, Inc. stockholders' equity	2,365,107	2,199,864
Noncontrolling interest	107,202	105,303
Total stockholders' equity	2,472,309	2,305,167
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 7,507,565</b>	<b>\$ 6,505,258</b>

*See accompanying notes.*



**Table of Contents****EXPEDIA, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Operating activities:</b>		
Net income	\$ 273,538	\$ 403,505
Less: Discontinued operations, net of tax	(22,346)	137,629
Net income from continuing operations	295,884	265,876
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation of property and equipment, including internal-use software and website development	116,854	97,627
Amortization of stock-based compensation	48,910	39,334
Amortization of intangible assets	21,527	17,312
Deferred income taxes	16,219	8,746
Foreign exchange (gain) loss on cash, cash equivalents and short-term investments, net	(18,348)	18,494
Realized loss on foreign currency forwards	8,511	8,117
Other	17,495	9,823
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(192,105)	(82,523)
Prepaid expenses and other current assets	1,253	(31,595)
Accounts payable, merchant	290,809	193,010
Accounts payable, other, accrued expenses and other current liabilities	204,345	78,122
Deferred merchant bookings	634,764	396,480
Deferred revenue	7,790	(125)
<b>Net cash provided by operating activities from continuing operations</b>	<b>1,453,908</b>	<b>1,018,698</b>
<b>Investing activities:</b>		
Capital expenditures, including internal-use software and website development	(176,980)	(157,867)
Purchases of investments	(1,530,749)	(1,179,555)
Sales and maturities of investments	1,244,065	1,046,395
Acquisitions, net of cash acquired	(198,398)	(8,076)
Net settlement of foreign currency forwards	(8,511)	(8,117)
Other, net	(2,203)	1,039
<b>Net cash used in investing activities from continuing operations</b>	<b>(672,776)</b>	<b>(306,181)</b>
<b>Financing activities:</b>		
Treasury stock activity	(366,037)	(208,693)
Payment of dividends to stockholders	(42,470)	(57,732)
Proceeds from exercise of equity awards	232,658	23,127
Sales (purchases) of additional interests in controlled subsidiaries, net	(2,015)	70,626
Excess tax benefit on equity awards	28,433	5,241
Changes in restricted cash and cash equivalents	(2,752)	(4,011)
Other, net	(1,744)	2,182

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<b>Net cash used in financing activities from continuing operations</b>	(153,927)	(169,260)
<b>Net cash provided by continuing operations</b>	627,205	543,257
<b>Net cash provided by (used in) discontinued operations</b>	(7,607)	114,412
Effect of exchange rate changes on cash and cash equivalents	5,996	(13,279)
<b>Net increase in cash and cash equivalents</b>	625,594	644,390
Cash and cash equivalents at beginning of period	689,134	621,199
<b>Cash and cash equivalents at end of period</b>	<b>\$ 1,314,728</b>	<b>\$ 1,265,589</b>
<b>Supplemental cash flow information</b>		
Cash paid for interest from continuing operations	\$ 85,255	\$ 86,907
Income tax payments (refunds), net from continuing operations	(584)	16,237

*See accompanying notes.*

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### **Notes to Consolidated Financial Statements**

**September 30, 2012**

**(Unaudited)**

#### **Note 1 Basis of Presentation**

##### ***Description of Business***

Expedia, Inc. and its subsidiaries provide travel products and services to leisure and corporate travelers in the United States and abroad as well as various media and advertising offerings to travel and non-travel advertisers. These travel products and services are offered through a diversified portfolio of brands including: Expedia.com®, Hotels.com®, Hotwire.com, Expedia® Affiliate Network, Classic Vacations, Expedia Local Expert, Egencia, Expedia® CruiseShipCenters®, eLong, Inc. (eLong) and Venere Net SpA (Venere). In addition, many of these brands have related international points of sale. We refer to Expedia, Inc. and its subsidiaries collectively as Expedia, the Company, us, we and our these consolidated financial statements.

##### ***TripAdvisor Spin-Off***

On December 20, 2011, following the close of trading on the Nasdaq Stock Market, we completed the spin-off of TripAdvisor, Inc. (TripAdvisor), which consisted of the domestic and international operations previously associated with our TripAdvisor Media Group, to Expedia stockholders. We refer to this transaction as the spin-off. Immediately prior to the spin-off, Expedia effected a one-for-two reverse stock split. Accordingly, the results of operations, financial condition and cash flows of TripAdvisor have been presented as discontinued operations for all periods presented. Further, all Expedia common stock share information and related per share amounts in prior periods have been adjusted to reflect Expedia's one-for-two reverse stock split.

##### ***Basis of Presentation***

These accompanying financial statements present our results of operations, financial position and cash flows on a consolidated basis. The unaudited consolidated financial statements include Expedia, Inc., our wholly-owned subsidiaries, and entities we control, or in which we have a variable interest and are the primary beneficiary of expected cash profits or losses. We have eliminated significant intercompany transactions and accounts.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial reporting. We have included all adjustments necessary for a fair presentation of the results of the interim period. These adjustments consist of normal recurring items. Our interim unaudited consolidated financial statements are not necessarily indicative of results that may be expected for any other interim period or for the full year. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2011, previously filed with the Securities and Exchange Commission.

##### ***Accounting Estimates***

We use estimates and assumptions in the preparation of our interim unaudited consolidated financial statements in accordance with GAAP. Our estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of our interim unaudited consolidated financial statements. These estimates and assumptions also affect the reported amount of net income during any period. Our actual financial results could differ significantly from these estimates. The significant estimates underlying our interim unaudited consolidated financial statements include revenue recognition; recoverability of current and long-lived assets, intangible assets and goodwill; income and indirect taxes, such as potential settlements related to occupancy taxes; loss contingencies; loyalty program liabilities; stock-based compensation and accounting for derivative instruments.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)*****Reclassifications***

We have reclassified certain amounts related to our prior period results to conform to our current period presentation.

***Seasonality***

We generally experience seasonal fluctuations in the demand for our travel products and services. For example, traditional leisure travel bookings are generally the highest in the first three quarters as travelers plan and book their spring, summer and holiday travel. The number of bookings typically decreases in the fourth quarter. Because revenue in our merchant business is generally recognized when the travel takes place rather than when it is booked, revenue typically lags bookings by several weeks or longer. The seasonal revenue impact is exacerbated with respect to income by the more stable nature of our fixed costs. As a result, revenue and income are typically the lowest in the first quarter and highest in the third quarter.

**Note 2 Summary of Significant Accounting Policies*****Recently Adopted Accounting Pronouncements***

On January 1, 2012, we adopted the new Financial Accounting Standards Board ( FASB ) guidance on the presentation of comprehensive income. Specifically, the new guidance allows an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements, which is the approach we have selected. The new guidance eliminated the option to report other comprehensive income and its components in the statement of changes in stockholders' equity. While the new guidance changed the presentation of comprehensive income, there were no changes to the components that are recognized in net income or other comprehensive income from that of previous accounting guidance.

In July 2012, the FASB issued amended guidance that simplifies how entities test indefinite-lived intangible assets, other than goodwill, for impairment. Under the amended guidance, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. If the entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not impaired, the entity would not need to calculate the fair value of the asset. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. On October 1, 2012, we early adopted this guidance and our adoption did not materially impact our consolidated financial statements.

**Note 3 Acquisitions and Dispositions**

*Business Acquisitions.* During the second quarter of 2012, we acquired a travel management company in the Nordics. The following table summarizes the fair value of the assets acquired and liabilities assumed in conjunction with this acquisition, in thousands:

	September 30, 2012
Goodwill	\$ 127,029
Intangible assets with definite lives(1)	110,284
Net liabilities(2)	(26,170)
Total	\$ 211,143

(1) The weighted average life of acquired intangible assets was 8.1 years.

(2) Includes cash acquired of \$13 million.



**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

The business combination accounting is preliminary for up to 12 months after the acquisition date and subject to revision, and any change to the fair value of net assets acquired would be expected to lead to a corresponding change to the amount of goodwill recorded on a retroactive basis. The results of operations of the acquired business has been included in our consolidated results from transaction closing date forward; its effect on consolidated revenue and operating income during the three and nine months ended September 30, 2012 was not significant. For the nine months ended September 30, 2012, the acquisition accounted for approximately 2% of consolidated revenue and 1% of consolidated operating income.

*Discontinued Operations.* On December 20, 2011, we completed the spin-off of TripAdvisor, Inc., which included its flagship brand as well as 18 other travel media brands. Accordingly, we have presented the financial condition and results of operations of our former TripAdvisor Media Group segment in the consolidated financial statements through December 20, 2011 as discontinued operations. Additionally, the first quarter 2012 loss incurred to extinguish our 8.5% senior notes due 2016 (the 8.5% Notes) as a result of the spin-off was recorded as discontinued operations. See below for a full description of the extinguishment. Financial data for the discontinued operations for the three and nine months ended September 30, 2012 and 2011 was as follows:

	Three months ended September 30, 2012		Nine months ended September 30, 2011	
	2012	2011	2012	2011
	(In thousands)			
Revenue	\$	\$ 180,802	\$	\$ 498,330
Income (loss) before income taxes		68,746	(37,568)	209,217
Provision for income taxes	1,543	(30,180)	15,222	(71,588)
Net income (loss)	1,543	38,566	(22,346)	137,629
Net income attributable to noncontrolling interest		21		(118)
<b>Net income (loss) attributable to discontinued operations</b>	<b>\$ 1,543</b>	<b>\$ 38,587</b>	<b>\$ (22,346)</b>	<b>\$ 137,511</b>
<b>Earnings (loss) per share:</b>				
Basic	\$ 0.01	\$ 0.28	\$ (0.17)	\$ 1.01
Diluted	0.01	0.28	(0.16)	0.99
<b>Shares used in computing earnings per share:</b>				
Basic	135,968	136,176	133,919	136,632
Diluted	141,423	139,684	139,650	139,271

The indenture governing our \$400 million aggregate principal amount of 8.5% Notes contained certain covenants that could have restricted implementation of the spin-off. On December 20, 2011, prior to consummation of the spin-off, we gave Notice of Redemption to the bondholders, the effect of which was the bonds became due and payable on the redemption date at the redemption price. The redemption price was equal to 100% of the principal amount plus a make-whole premium as of, and accrued and unpaid interest to, the redemption date. The redemption date was defined as 30 days after the Notice of Redemption was given. In order to complete the Notice of Redemption, we were required to irrevocably deposit, with the Trustee, funds sufficient to pay the redemption price plus accrued interest on the 8.5% Notes (approximately \$451 million). The 8.5% Notes were fully redeemed on January 19, 2012, the redemption date, for approximately \$450 million. In connection with the redemption, we incurred a pre-tax loss from early extinguishment of debt of approximately \$38 million (or \$24 million net of tax), which included an early redemption premium of \$33 million and the write-off of \$5 million of unamortized debt issuance and discount costs. This loss was recorded within discontinued operations in the first quarter of 2012, as that was the period in which the bonds were legally extinguished.

As a result of the above, at December 31, 2011, we had a current asset of discontinued operations of \$456 million primarily related to the deposit for the redemption price of the 8.5% Notes as well as a current liability of discontinued operations of \$420 million for the 8.5% Notes, accrued interest expense related to the 8.5% Notes and accrued spin-off costs. At September 30, 2012, the current asset of discontinued operations included a \$16 million tax benefit primarily related to the loss on the extinguishment of debt.



**Table of Contents****Notes to Consolidated Financial Statements (Continued)****Note 4 Fair Value Measurements**

Financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2012 are classified using the fair value hierarchy in the table below:

	<b>Total</b>	<b>Level 1 (In thousands)</b>	<b>Level 2</b>
<b>Assets</b>			
Cash equivalents:			
Money market funds	\$ 570,426	\$ 570,426	\$
Time deposits	101,929		101,929
Investments:			
Time deposits	916,491		916,491
Corporate debt securities	240,127		240,127
 Total assets	 \$ 1,828,973	 \$ 570,426	 \$ 1,258,547
<b>Liabilities</b>			
Foreign currency forward contracts	\$ 4,977	\$	\$ 4,977

Financial assets measured at fair value on a recurring basis as of December 31, 2011 are classified using the fair value hierarchy in the table below:

	<b>Total</b>	<b>Level 1 (In thousands)</b>	<b>Level 2</b>
<b>Assets</b>			
Cash equivalents:			
Money market funds	\$ 310,075	\$ 310,075	\$
Derivatives:			
Foreign currency forward contracts	1,043		1,043
Investments:			
Time deposits	592,162		592,162
Corporate debt securities	268,664		268,664
 Total assets	 \$ 1,171,944	 \$ 310,075	 \$ 861,869

We classify our cash equivalents and investments within Level 1 and Level 2 as we value our cash equivalents and investments using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Valuation of the foreign currency forward contracts is based on foreign currency exchange rates in active markets, a Level 2 input.

As of September 30, 2012 and December 31, 2011, our cash and cash equivalents consisted primarily of prime institutional money market funds with maturities of 90 days or less, time deposits as well as bank account balances.

We invest in investment grade corporate debt securities all of which are classified as available for sale. As of September 30, 2012, we had \$126 million of short-term and \$114 million of long-term available for sale investments and the amortized cost basis of the investments approximated their fair value with gross unrealized gains of \$3 million and gross unrealized losses of less than \$1 million. As of December 31, 2011, we had \$57 million of short-term and \$212 million of long-term available for sale investments and the amortized cost basis of these investments



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approximated their fair value with gross unrealized gains of \$2 million and gross unrealized losses of \$1 million.

We also hold time deposit investments with financial institutions. Time deposits with original maturities of less than 90 days are classified as cash equivalents and those with remaining maturities of less than one year are classified as short-term investments. Of the total time deposit investments, \$242 million and \$228 million as of September 30, 2012 and December 31, 2011 related to balances held by our majority-owned subsidiaries.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

Derivative instruments are carried at fair value on our consolidated balance sheets. We use foreign currency forward contracts to economically hedge certain merchant revenue exposures and in lieu of holding certain foreign currency cash for the purpose of economically hedging our foreign currency-denominated operating liabilities. Our goal in managing our foreign exchange risk is to reduce, to the extent practicable, our potential exposure to the changes that exchange rates might have on our earnings, cash flows and financial position. Our foreign currency forward contracts are typically short-term and, as they do not qualify for hedge accounting treatment, we classify the changes in their fair value in other, net. As of September 30, 2012, we were party to outstanding forward contracts hedging our liability and revenue exposures with a total net notional value of \$1.1 billion. We had a net forward liability of \$5 million as of September 30, 2012 recorded in accrued expenses and other current liabilities and a net forward asset of \$1 million as of December 31, 2011 recorded in prepaid expenses and other current assets. We recorded \$22 million in net losses and \$5 million in net gains from foreign currency forward contracts during the three months ended September 30, 2012 and 2011, and \$18 million and less than \$1 million in net losses for the nine months ended September 30, 2012 and 2011.

**Note 5 Debt**

The following table sets forth our outstanding debt:

	September 30, 2012	December 31, 2011
	(In thousands)	
7.456% senior notes due 2018	\$ 500,000	\$ 500,000
5.95% senior notes due 2020, net of discount	749,328	749,281
Long-term debt	\$ 1,249,328	\$ 1,249,281

We have excluded from the above table the \$400 million 8.5% Notes, which were included in current liabilities of discontinued operations as of December 31, 2011 in the consolidated balance sheets and were redeemed on January 19, 2012. For further information, see Note 3 Acquisitions and Dispositions.

**Long-term Debt**

Our \$500 million in registered senior unsecured notes outstanding at September 30, 2012 are due in August 2018 and bear interest at 7.456% (the 7.456% Notes). Interest is payable semi-annually in February and August of each year. The 7.456% Notes are repayable in whole or in part on August 15, 2013, at the option of the holders of such 7.456% Notes, at 100% of the principal amount plus accrued interest. As of September 30, 2012, the 7.456% Notes have been classified as long-term debt as we have the ability to draw on our revolving credit facility described below in the event the 7.456% Notes were redeemed at the option of the holders. We may redeem the 7.456% Notes at a redemption price of 100% of the principal plus accrued interest, plus a make-whole premium, in whole or in part at any time at our option.

Our \$750 million in registered senior unsecured notes outstanding at September 30, 2012 are due in August 2020 and bear interest at 5.95% (the 5.95% Notes). The 5.95% Notes were issued at 99.893% of par resulting in a discount, which is being amortized over their life. Interest is payable semi-annually in February and August of each year. We may redeem the 5.95% Notes at a redemption price of 100% of the principal plus accrued interest, plus a make-whole premium, in whole or in part at any time or from time to time at our option.

The 7.456% and 5.95% Notes (collectively the Notes) are senior unsecured obligations guaranteed by certain domestic Expedia subsidiaries and rank equally in right of payment with all of our existing and future unsecured and unsubordinated obligations. For further information, see Note 11 Guarantor and Non-Guarantor Supplemental Financial Information. In addition, the Notes include covenants that limit our ability (i) to create or incur liens, (ii) to enter into sale/leaseback transactions and (iii) to merge or consolidate with or into another entity. Accrued interest related to the Notes was \$10 million as of September 30, 2012 and \$31 million as December 31, 2011.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

Based on quoted market prices, the estimated fair value of 7.456% Notes was approximately \$589 million and \$563 million as of September 30, 2012, and December 31, 2011, and the estimated fair value of 5.95% Notes was approximately \$825 million and \$760 million as of September 30, 2012, and December 31, 2011.

**Credit Facility**

Expedia, Inc. maintains a \$750 million unsecured revolving credit facility with a group of lenders, which is unconditionally guaranteed by certain domestic Expedia subsidiaries that are the same as under the Notes and expires in August 2016. As of September 30, 2012 and December 31, 2011, we had no revolving credit facility borrowings outstanding. The facility bears interest based on the Company's credit ratings, with drawn amounts bearing interest at LIBOR plus 150 basis points and the commitment fee on undrawn amounts at 22.5 basis points as of September 30, 2012. The facility contains financial covenants including leverage and minimum interest coverage ratios.

The amount of stand-by letters of credit ( LOC ) issued under the facility reduces the credit amount available. As of September 30, 2012, and December 31, 2011, there was \$22 million for both periods of outstanding stand-by LOCs issued under the facility.

**Note 6 Stockholders' Equity****Dividends on our Common Stock**

The Executive Committee, acting on behalf of the Board of Directors, declared the following dividends during the periods presented, which have been adjusted for the one-for-two reverse stock split in December 2011:

Declaration Date	Dividend Per Share	Record Date	Total Amount (in thousands)	Payment Date
<b>Nine months ended September 30, 2012:</b>				
February 9, 2012	\$ 0.09	March 12, 2012	\$ 12,204	March 30, 2012
April 25, 2012	0.09	May 30, 2012	12,205	June 19, 2012
July 25, 2012	0.13	August 28, 2012	18,061	September 18, 2012
<b>Nine months ended September 30, 2011:</b>				
February 9, 2011	\$ 0.14	March 11, 2011	\$ 19,352	March 31, 2011
April 27, 2011	0.14	May 27, 2011	19,232	June 17, 2011
July 26, 2011	0.14	August 26, 2011	19,148	September 16, 2011

In addition, on October 24, 2012, the Executive Committee, acting on behalf of the Board of Directors, declared a quarterly cash dividend of \$0.13 per share of outstanding common stock payable on December 7, 2012 to stockholders of record as of the close of business on November 16, 2012. Future declarations of dividends are subject to final determination of our Board of Directors.

**Share Repurchases**

In 2010, the Executive Committee, acting on behalf of the Board of Directors, authorized a repurchase of up to 20 million outstanding shares of our common stock. On April 25, 2012, the Executive Committee, acting on behalf of the Board of Directors, authorized an additional repurchase of up to 20 million outstanding shares of our common stock. During the first nine months of 2012, we repurchased, through open market transactions, 9.9 million shares available under the authorizations for a total cost of \$351 million, excluding transaction costs, representing an average repurchase price of \$35.60 per share. As of September 30, 2012, 18.9 million shares remain authorized for repurchase under the April 2012 authorization with no fixed termination date for the repurchases. Subsequent to the end of the third quarter of 2012, we repurchased an additional 0.8 million shares for a total cost of \$46 million, excluding transaction costs, representing an average purchase price of \$55.36 per share.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)*****Stock-based Awards***

During second quarter of 2012, we issued 7.3 million shares of Expedia, Inc. common stock as a result of the exercise of 30 million privately held warrants at a weighted average exercise price of \$23.98 for total proceeds to the Company of approximately \$175 million. As of September 30, 2012, we did not have any warrants outstanding.

***Noncontrolling Interest***

During the nine months ended September 30, 2012, there were no significant ownership interest changes in noncontrolling interest. In May 2011, we acquired additional shares of eLong for \$41 million and, at the same time, Tencent Holdings Limited also acquired approximately 16% of the outstanding shares of eLong for \$84 million. The following table shows the effects of the changes in noncontrolling interest for the nine months ended September 30, 2011, in thousands:

	<b>Nine months ended September 30, 2011</b>
Net income attributable to Expedia, Inc.	\$ 401,966
Transfers (to) from the noncontrolling interest due to:	
Net increase in Expedia, Inc.'s paid-in capital for newly issued eLong shares (1)	25,957
Net transfers from noncontrolling interest	25,957
Change from net income attributable to Expedia, Inc. and transfers from noncontrolling interest	\$ 427,923

(1) Primarily due to our acquisition of 5.4 million newly issued shares of eLong and, at the same time, Tencent Holdings Limited acquisition of 11.1 million newly issued shares of eLong in the second quarter of 2011.  
As of September 30, 2012, our ownership interest in eLong was approximately 67%.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)****Note 7 Earnings Per Share**

The following table presents our basic and diluted earnings per share:

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands, except per share data)</b>			
<b>Income from continuing operations attributable to Expedia, Inc.</b>	<b>\$ 169,934</b>	<b>\$ 170,947</b>	<b>\$ 295,783</b>	<b>\$ 264,455</b>
<b>Earnings per share from continuing operations attributable to Expedia, Inc. available to common stockholders:</b>				
Basic	\$ 1.25	\$ 1.26	\$ 2.21	\$ 1.94
Diluted	1.20	1.22	2.12	1.90
<b>Weighted average number of shares outstanding:</b>				
Basic	135,968	136,176	133,919	136,632
Dilutive effect of:				
Options to purchase common stock	4,890	2,081	4,107	1,764
Other dilutive securities	565	1,427	1,624	875
Diluted	141,423	139,684	139,650	139,271

The earnings per share amounts are the same for common stock and Class B common stock because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

**Note 8 Commitments and Contingencies*****Legal Proceedings***

In the ordinary course of business, we are a party to various lawsuits. Management does not expect these lawsuits to have a material impact on the liquidity, results of operations, or financial condition of Expedia. We also evaluate other potential contingent matters, including value-added tax, federal excise tax, transient occupancy or accommodation tax and similar matters. We do not believe that the aggregate amount of liability that could be reasonably possible with respect to these matters would have a material adverse effect on our financial results; however, litigation is inherently uncertain and the actual losses incurred in the event that our legal proceedings were to result in unfavorable outcomes could have a material adverse effect on our business and financial performance.

*Litigation Relating to Hotel Occupancy Taxes.* Eighty lawsuits have been filed by cities, counties and states involving hotel occupancy taxes. Forty-four lawsuits are currently active. These lawsuits are in various stages and we continue to defend against the claims made in them vigorously. With respect to the principal claims in these matters, we believe that the ordinances at issue do not apply to the services we provide, namely the facilitation of hotel reservations, and, therefore, that we do not owe the taxes that are claimed to be owed. We believe that the ordinances at issue generally impose occupancy and other taxes on entities that own, operate or control hotels (or similar businesses) or furnish or provide hotel rooms or similar accommodations. To date, thirty of these lawsuits have been dismissed. Some of these dismissals have been without prejudice and, generally, allow the governmental entity or entities to seek administrative remedies prior to pursuing further litigation. Eighteen dismissals were based on a finding that we and the other defendants were not subject to the local hotel occupancy tax ordinance or that the local government lacked standing to pursue their claims. As a result of this litigation and other attempts by certain jurisdictions to levy such taxes, we have established a reserve for the potential settlement of issues related to hotel occupancy taxes, consistent with applicable accounting principles and in light of all current facts and circumstances, in the amount of \$36 million as of September 30, 2012 and \$32 million as of December 31, 2011. This reserve is based on our best estimate and the ultimate resolution of these



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### **Notes to Consolidated Financial Statements (Continued)**

contingencies may be greater or less than the liabilities recorded. In addition, as of December 31, 2011, we had an accrual totaling \$10 million related to court decisions and final settlements. Changes to these settlement reserves are included within legal reserves, occupancy tax and other in the consolidated statements of operations.

In connection with various occupancy tax audits and assessments, certain jurisdictions may assert that taxpayers are required to pay any assessed taxes prior to being allowed to contest or litigate the applicability of the ordinances, which is referred to as pay-to-play. These jurisdictions may attempt to require that we pay any assessed taxes prior to being allowed to contest or litigate the applicability of the tax ordinance. Payment of these amounts is not an admission that we believe we are subject to such taxes and, even when such payments are made, we continue to defend our position vigorously. During 2010 and 2009, we expensed \$3 million and \$48 million related to monies paid in advance of litigation in occupancy tax proceedings in the cities of Santa Monica and San Francisco. In each case, we paid such amounts in order to be allowed to pursue litigation challenging whether we are required to pay hotel occupancy tax on the portion of the customer payment we retain as compensation and, if so, the actual amounts owed. We do not believe that the amounts we retain as compensation are subject to the cities' hotel occupancy tax ordinances. If we prevail in the litigation (including any appeal), the cities will be required to repay these amounts, plus interest. In December 2011, the city of Santa Monica returned the \$3 million in exchange for a letter of credit. In June 2012, the city of San Francisco issued additional assessments of tax, penalties and interest for the time period from the fourth quarter of 2007 through the fourth quarter of 2011 against the travel companies, including \$22 million against Expedia, Hotels.com and Hotwire. The additional assessments, including the prepayment of such assessments, have been contested by the online companies.

*Matters Relating to Hotel Booking Practices.* On July 31, 2012, the United Kingdom Office of Fair Trading (OFT) issued a Statement of Objections alleging that Expedia, Booking.com B.V. and InterContinental Hotels Group PLC (IHG) have infringed European Union and United Kingdom competition law in relation to the online supply of hotel room accommodations. The Statement of Objections alleges that Expedia and Booking.com entered into separate agreements with IHG that restricted each online travel company's ability to discount the price of IHG hotel rooms. The OFT limited its investigation to a small number of companies, but has stated that the investigation is likely to have wider implications for the industry within the United Kingdom.

The Statement of Objections does not constitute a finding of infringement and all parties have the opportunity to respond. If the OFT maintains its objections after the companies' responses, the OFT can issue a final decision. In such a case a final decision would be issued at the earliest in 2013. An appeal of an adverse OFT decision is to the English courts but may involve a reference on matters of European Union law to the European Court of Justice. We are unable at this time to predict the outcome of the OFT proceeding and any appeal. In addition, a number of competition authorities in other European countries have initiated investigations in relation to certain contractual arrangements between hotels and online travel companies, including Expedia. These investigations differ in relation to the parties involved and the precise nature of the concerns.

Since August 20, 2012, twenty-one putative class action lawsuits, which refer to the OFT's Statement of Objections, have been initiated in the United States by consumer plaintiffs alleging claims against the online travel companies, including Expedia, and several major hotel chains for alleged resale price maintenance for online hotel room reservations, including but not limited to violation of the Sherman Act, state antitrust laws, state consumer protection statutes and common law tort claims, such as unjust enrichment. The cases are currently pending in multiple federal and state courts. The parties have moved before the Judicial Panel on Multi-District Litigation for consolidation of the cases.

#### **Note 9 Related Party Transactions**

Mr. Diller, our Chairman of the Board of Directors and Senior Executive, through shares he owns beneficially as well as those subject to an irrevocable proxy granted by Liberty Interactive Corporation, controlled approximately 62% of the combined voting power of the outstanding Expedia capital stock as of September 30, 2012. On October 9, 2012, Liberty sold a portion of its common stock holdings after which Mr. Diller's combined voting power was approximately 57%.

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### **Notes to Consolidated Financial Statements (Continued)**

Mr. Diller effectively controls the outcome of all matters submitted to a vote or for the consent of our stockholders (other than with respect to the election by the holders of common stock of 25% of the members of our Board of Directors and matters as to which Delaware law requires a separate class vote). Upon Mr. Diller's permanent departure from Expedia, the irrevocable proxy would terminate and depending on the capitalization of Expedia at such time, Liberty could effectively control the voting power of our capital stock.

In addition to serving as our Chairman and Senior Executive, Mr. Diller also serves as Chairman of the Board of Directors and Senior Executive at both IAC and TripAdvisor. Certain of our other executives also maintain roles with both IAC and TripAdvisor. Our certificate of incorporation provides that no officer or director of Expedia who is also an officer or director of IAC or of TripAdvisor will be liable to Expedia or its stockholders for breach of any fiduciary duty by reason of the fact that any such individual directs a corporate opportunity to IAC or TripAdvisor instead of Expedia, or does not communicate information regarding a corporate opportunity to Expedia because the officer or director has directed the corporate opportunity to IAC or TripAdvisor, which could have the effect of increasing the risk of conflicts of interest between the companies.

*TripAdvisor, Inc.* In connection with the spin-off, we entered into various agreements with TripAdvisor, a related party due to common ownership, including, among others, a separation agreement, a tax sharing agreement, an employee matters agreement and a transition services agreement. In addition, we will continue to work with TripAdvisor pursuant to various commercial agreements between subsidiaries of Expedia, on the one hand, and subsidiaries of TripAdvisor, on the other hand. The various commercial agreements, including click-based advertising agreements, content sharing agreements and display-based and other advertising agreements, have terms of up to one year. We recognized approximately \$2 million and \$5 million of revenue and expensed approximately \$57 million and \$164 million related to these various agreements with TripAdvisor during the three and nine months ended September 30, 2012. In addition, we reclassified sales and marketing expense related to amounts we paid to TripAdvisor prior to the spin-off, which were previously eliminated in consolidation, to third party expenses for the three and nine months ended September 30, 2011. Net amounts payable to TripAdvisor were \$32 million and \$14 million as of September 30, 2012 and December 31, 2011 and were primarily included in accounts payable, other on the consolidated balance sheet.

#### **Note 10 Segment Information**

We have two reportable segments: Leisure and Egencia. We determined our segments based on how our chief operating decision makers manage our business, make operating decisions and evaluate operating performance. Our primary operating metric is adjusted EBITDA. Adjusted EBITDA for our Leisure and Egencia segments includes allocations of certain expenses, primarily cost of revenue and facilities, and our Leisure segment includes the total costs of our global supply organizations as well as the realized foreign currency gains or losses related to the forward contracts hedging a component of our net merchant hotel revenue. We base the allocations primarily on transaction volumes and other usage metrics. We do not allocate certain shared expenses such as accounting, human resources, information technology and legal to our reportable segments. We include these expenses in Corporate. Our allocation methodology is periodically evaluated and may change.

Our Leisure segment provides a full range of travel and advertising services to our worldwide customers through a variety of brands including: Expedia.com and Hotels.com in the United States and localized Expedia and Hotels.com websites throughout the world, Expedia Affiliate Network, Hotwire.com, Venere, eLong and Classic Vacations. Our Egencia segment provides managed travel services to corporate customers in North America, Europe, and the Asia Pacific region.

Corporate also includes unallocated corporate functions and expenses. In addition, we record amortization of intangible assets and any related impairment, as well as stock-based compensation expense, restructuring charges, legal reserves, occupancy tax and other, and other items excluded from segment operating performance in Corporate. Such amounts are detailed in our segment reconciliation below.



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### Notes to Consolidated Financial Statements (Continued)

The following tables present our segment information for the three and nine months ended September 30, 2012 and 2011. As a significant portion of our property and equipment is not allocated to our operating segments and depreciation is not included in our segment measure, we do not report the assets by segment as it would not be meaningful. We do not regularly provide such information to our chief operating decision makers.

	Three months ended September 30, 2012			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	\$ 1,121,267	\$ 77,753	\$	\$ 1,199,020
Adjusted EBITDA	\$ 357,032	\$ 12,446	\$ (75,902)	\$ 293,576
Depreciation	(20,323)	(3,051)	(20,500)	(43,874)
Amortization of intangible assets			(9,474)	(9,474)
Stock-based compensation			(15,338)	(15,338)
Legal reserves, occupancy tax and other			(2,310)	(2,310)
Realized loss on revenue hedges	4,510			4,510
Operating income (loss)	\$ 341,219	\$ 9,395	\$ (123,524)	227,090
Other expense, net				(22,752)
Income from continuing operations before income taxes				204,338
Provision for income taxes				(36,150)
Income from continuing operations				168,188
Discontinued operations, net of taxes				1,543
Net income				169,731
Net loss attributable to noncontrolling interests				1,746
<b>Net income attributable to Expedia, Inc.</b>				<b>\$ 171,477</b>

	Three months ended September 30, 2011			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	\$ 976,148	\$ 44,302	\$	\$ 1,020,450
Adjusted EBITDA	\$ 344,417	\$ 5,117	\$ (71,857)	\$ 277,677
Depreciation	(15,649)	(2,187)	(18,955)	(36,791)
Amortization of intangible assets			(5,564)	(5,564)
Stock-based compensation			(13,023)	(13,023)
Legal reserves, occupancy tax and other			(14,015)	(14,015)
Realized loss on revenue hedges	815			815
Operating income (loss)	\$ 329,583	\$ 2,930	\$ (123,414)	209,099
Other expense, net				(6,660)
Income from continuing operations before income taxes				202,439

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Provision for income taxes	(30,599)
Income from continuing operations	171,840
Discontinued operations, net of taxes	38,566
Net income	210,406
Net income attributable to noncontrolling interests	(872)
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 209,534</b>

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## Notes to Consolidated Financial Statements (Continued)

	Nine months ended September 30, 2012			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	\$ 2,849,332	\$ 206,156	\$	\$ 3,055,488
Adjusted EBITDA	\$ 811,307	\$ 40,168	\$ (233,180)	\$ 618,295
Depreciation	(53,580)	(7,796)	(55,478)	(116,854)
Amortization of intangible assets			(21,527)	(21,527)
Stock-based compensation			(48,910)	(48,910)
Legal reserves, occupancy tax and other			(5,384)	(5,384)
Realized loss on revenue hedges	4,594			4,594
Operating income (loss)	\$ 762,321	\$ 32,372	\$ (364,479)	430,214
Other expense, net				(64,185)
Income from continuing operations before income taxes				366,029
Provision for income taxes				(70,145)
Income from continuing operations				295,884
Discontinued operations, net of taxes				(22,346)
Net income				273,538
Net income attributable to noncontrolling interests				(101)
<b>Net income attributable to Expedia, Inc.</b>				<b>\$ 273,437</b>

	Nine months ended September 30, 2011			
	Leisure	Egencia	Corporate	Total
	(In thousands)			
Revenue	\$ 2,527,964	\$ 133,912	\$	\$ 2,661,876
Adjusted EBITDA	\$ 748,270	\$ 22,410	\$ (221,980)	\$ 548,700
Depreciation	(41,915)	(6,355)	(49,357)	(97,627)
Amortization of intangible assets			(17,312)	(17,312)
Stock-based compensation			(39,334)	(39,334)
Legal reserves, occupancy tax and other			(18,904)	(18,904)
Realized loss on revenue hedges	12,441			12,441
Operating income (loss)	\$ 718,796	\$ 16,055	\$ (346,887)	387,964
Other expense, net				(55,471)
Income from continuing operations before income taxes				332,493
Provision for income taxes				(66,617)
Income from continuing operations				265,876
Discontinued operations, net of taxes				137,629
Net income				403,505
Net income attributable to noncontrolling interests				(1,539)

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**Net income attributable to Expedia, Inc.**

\$ 401,966

During the first quarter of 2012, we changed our allocation methodology for information technology expenses, which resulted in an increase of expenses at Corporate and a corresponding decrease in expenses being allocated to our Leisure and Egencia segments. In addition, in conjunction with certain organizational changes, we reclassified expenses

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

attributed to our supplier payment group previously captured within Leisure to Corporate. We revised prior year adjusted EBITDA by segment to conform to our current year presentation. There was no impact on consolidated adjusted EBITDA as a result of these changes.

**Note 11 Guarantor and Non-Guarantor Supplemental Financial Information**

Condensed consolidating financial information of Expedia, Inc. (the Parent), our subsidiaries that are guarantors of our debt facility and instruments (the Guarantor Subsidiaries), and our subsidiaries that are not guarantors of our debt facility and instruments (the Non-Guarantor Subsidiaries) is shown below. The debt facility and instruments are guaranteed by certain of our wholly-owned domestic subsidiaries and rank equally in right of payment with all of our existing and future unsecured and unsubordinated obligations. The guarantees are full, unconditional, joint and several with the exception of certain customary automatic subsidiary release provisions. In this financial information, the Parent and Guarantor Subsidiaries account for investments in their wholly-owned subsidiaries using the equity method.

In connection with the spin-off, TripAdvisor Holdings, LLC and TripAdvisor LLC, both post-spin-off subsidiaries of TripAdvisor, were released from their guarantees of obligations under our existing debt facility and instruments. The discontinued operations of TripAdvisor and its subsidiaries have been presented within the following condensed consolidating financial statements within Guarantor Subsidiaries and Non-Guarantor Subsidiaries consistent with the classification in prior periods. In addition, in connection with the spin-off and the Notice of Redemption of the 8.5% Notes as described in Note 3 Acquisitions and Dispositions, such 8.5% Notes and the related deposit for the redemption were included within total current liabilities and total current assets of the Parent as of December 31, 2011.

**CONDENSED CONSOLIDATING STATEMENT OF OPERATION****Three months ended September 30, 2012**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
Revenue	\$	\$ 1,039,520	\$ 160,882	\$ (1,382)	\$ 1,199,020
Costs and expenses:					
Cost of revenue		194,103	48,996	534	243,633
Selling and marketing		374,409	133,420	(2,073)	505,756
Technology and content		90,427	35,232	(42)	125,617
General and administrative		55,112	29,829	199	85,140
Amortization of intangible assets		1,555	7,919		9,474
Legal reserves, occupancy tax and other		2,310			2,310
Intercompany (income) expense, net		207,291	(207,291)		
Operating income		114,313	112,777		227,090
Other income (expense):					
Equity in pre-tax earnings of consolidated subsidiaries	183,803	112,800		(296,603)	
Other, net	(20,835)	(3,871)	1,954		(22,752)
Total other income (expense), net	162,968	108,929	1,954	(296,603)	(22,752)
Income before income taxes	162,968	223,242	114,731	(296,603)	204,338
Provision for income taxes	6,966	(38,609)	(4,507)		(36,150)
Income from continuing operations	169,934	184,633	110,224	(296,603)	168,188
Discontinued operations, net of taxes	1,543				1,543

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Net income	171,477	184,633	110,224	(296,603)	169,731
Net loss attributable to noncontrolling interests			1,746		1,746
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 171,477</b>	<b>\$ 184,633</b>	<b>\$ 111,970</b>	<b>\$ (296,603)</b>	<b>\$ 171,477</b>
Comprehensive income attributable to Expedia, Inc.	\$ 171,477	\$ 184,921	\$ 125,859	\$ (296,603)	\$ 185,654

**Table of Contents****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENT OF OPERATION****Three months ended September 30, 2011**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenue	\$	\$ 895,434	\$ 128,580	\$ (3,564)	\$ 1,020,450
Costs and expenses:					
Cost of revenue		177,489	28,480	482	206,451
Selling and marketing		300,216	111,912	(3,959)	408,169
Technology and content		76,655	21,922	(105)	98,472
General and administrative		54,029	24,633	18	78,680
Amortization of intangible assets		1,230	4,334		5,564
Legal reserves, occupancy tax and other		14,015			14,015
Intercompany (income) expense, net		175,848	(175,848)		
Operating income		95,952	113,147		209,099
Other income (expense):					
Equity in pre-tax earnings of consolidated subsidiaries	185,509	89,058		(274,567)	
Other, net	(20,914)	38,803	(24,549)		(6,660)
Total other income (expense), net	164,595	127,861	(24,549)	(274,567)	(6,660)
Income before income taxes	164,595	223,813	88,598	(274,567)	202,439
Provision for income taxes	6,278	(37,160)	283		(30,599)
Income from continuing operations	170,873	186,653	88,881	(274,567)	171,840
Discontinued operations, net of taxes	38,661	38,457	48,028	(86,580)	38,566
Net income	209,534	225,110	136,909	(361,147)	210,406
Net income attributable to noncontrolling interests			(872)		(872)
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 209,534</b>	<b>\$ 225,110</b>	<b>\$ 136,037</b>	<b>\$ (361,147)</b>	<b>\$ 209,534</b>
Comprehensive income attributable to Expedia, Inc.	\$ 209,534	\$ 224,334	\$ 100,453	\$ (361,214)	\$ 173,107

**CONDENSED CONSOLIDATING STATEMENT OF OPERATION****Nine months ended September 30, 2012**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenue	\$	\$ 2,664,255	\$ 395,282	\$ (4,049)	\$ 3,055,488
Costs and expenses:					
Cost of revenue		550,129	122,354	989	673,472

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Selling and marketing	990,527	342,646	(5,772)	1,327,401
Technology and content	260,231	90,773	(450)	350,554
General and administrative	161,570	84,182	1,184	246,936
Amortization of intangible assets	4,888	16,639		21,527
Legal reserves, occupancy tax and other	5,384			5,384
Intercompany (income) expense, net	521,952	(521,952)		
Operating income	169,574	260,640		430,214
Other income (expense):				
Equity in pre-tax earnings of consolidated subsidiaries	333,172	251,410	(584,582)	
Other, net	(62,536)	(39,564)	37,915	(64,185)
Total other income (expense), net	270,636	211,846	37,915	(584,582)
Income from continuing operations before income taxes	270,636	381,420	298,555	(584,582)
Provision for income taxes	25,147	(45,614)	(49,678)	(70,145)
Income from continuing operations	295,783	335,806	248,877	(584,582)
Discontinued operations, net of taxes	(22,346)			(22,346)
Net income	273,437	335,806	248,877	(584,582)
Net income attributable to noncontrolling interests			(101)	(101)
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 273,437</b>	<b>\$ 335,806</b>	<b>\$ 248,776</b>	<b>\$ (584,582)</b>
Comprehensive income attributable to Expedia, Inc.	\$ 273,437	\$ 336,580	\$ 252,768	\$ (584,582)



**Table of Contents****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENT OF OPERATION****Nine months ended September 30, 2011**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
Revenue	\$	\$ 2,336,627	\$ 335,983	\$ (10,734)	\$ 2,661,876
Costs and expenses:					
Cost of revenue		496,348	80,824	699	577,871
Selling and marketing		853,292	317,690	(11,422)	1,159,560
Technology and content		222,785	55,754	(159)	278,380
General and administrative		157,116	64,621	148	221,885
Amortization of intangible assets		3,752	13,560		17,312
Legal reserves, occupancy tax and other		18,904			18,904
Intercompany (income) expense, net		455,384	(455,384)		
Operating income		129,046	258,918		387,964
Other income (expense):					
Equity in pre-tax earnings of consolidated subsidiaries	307,997	212,186		(520,183)	
Other, net	(62,530)	9,771	(2,712)		(55,471)
Total other income (expense), net	245,467	221,957	(2,712)	(520,183)	(55,471)
Income before income taxes	245,467	351,003	256,206	(520,183)	332,493
Provision for income taxes	18,775	(40,270)	(45,122)		(66,617)
Income from continuing operations	264,242	310,733	211,084	(520,183)	265,876
Discontinued operations, net of taxes	137,724	143,283	112,397	(255,775)	137,629
Net income	401,966	454,016	323,481	(775,958)	403,505
Net income attributable to noncontrolling interests			(1,539)		(1,539)
<b>Net income attributable to Expedia, Inc.</b>	<b>\$ 401,966</b>	<b>\$ 454,016</b>	<b>\$ 321,942</b>	<b>\$ (775,958)</b>	<b>\$ 401,966</b>
Comprehensive income attributable to Expedia, Inc.	\$ 401,966	\$ 453,926	\$ 317,016	\$ (775,958)	\$ 396,950

**CONDENSED CONSOLIDATING BALANCE SHEET****September 30, 2012**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Total current assets	\$ 135,432	\$ 2,805,523	\$ 918,942	\$ (768,487)	\$ 3,091,410
Investment in subsidiaries	4,244,307	1,284,243		(5,528,550)	

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Intangible assets, net	636,408	191,910	828,318
Goodwill	2,436,533	570,429	3,006,962
Other assets, net	4,973	430,119	145,783
580,875			
<b>TOTAL ASSETS</b>	<b>\$ 4,384,712</b>	<b>\$ 7,592,826</b>	<b>\$ 1,827,064</b>
			<b>\$ (6,297,037)</b>
			<b>\$ 7,507,565</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Total current liabilities	\$ 663,075	\$ 2,988,327	\$ 415,664
Long-term debt	1,249,328		\$ (768,487)
Other liabilities		354,238	\$ 3,298,579
Stockholders' equity	2,472,309	4,250,261	1,249,328
		133,111	
		1,278,289	487,349
		(5,528,550)	2,472,309
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 4,384,712</b>	<b>\$ 7,592,826</b>	<b>\$ 1,827,064</b>
			<b>\$ (6,297,037)</b>
			<b>\$ 7,507,565</b>

**Table of Contents****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING BALANCE SHEET****December 31, 2011**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Total current assets	\$ 551,488	\$ 1,538,509	\$ 644,825	\$ (460,393)	\$ 2,274,429
Investment in subsidiaries	3,891,811	1,126,412		(5,018,223)	
Intangible assets, net		634,581	109,317		743,898
Goodwill		2,415,482	461,819		2,877,301
Other assets, net	5,587	465,473	138,570		609,630
<b>TOTAL ASSETS</b>	<b>\$ 4,448,886</b>	<b>\$ 6,180,457</b>	<b>\$ 1,354,531</b>	<b>\$ (5,478,616)</b>	<b>\$ 6,505,258</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Total current liabilities	\$ 894,438	\$ 1,906,349	\$ 212,963	\$ (460,393)	\$ 2,553,357
Long-term debt	1,249,281				1,249,281
Other liabilities		378,729	18,724		397,453
Stockholders' equity	2,305,167	3,895,379	1,122,844	(5,018,223)	2,305,167
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 4,448,886</b>	<b>\$ 6,180,457</b>	<b>\$ 1,354,531</b>	<b>\$ (5,478,616)</b>	<b>\$ 6,505,258</b>

**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****Nine months ended September 30, 2012**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Consolidated</b>
<b>Operating activities:</b>				
Net cash provided by operating activities from continuing operations	\$	\$ 1,270,214	\$ 183,694	\$ 1,453,908
<b>Investing activities:</b>				
Capital expenditures, including internal-use software and website development		(143,051)	(33,929)	(176,980)
Purchases of investments		(1,265,212)	(265,537)	(1,530,749)
Sales and maturities of investments		992,292	251,773	1,244,065
Acquisitions, net of cash acquired			(198,398)	(198,398)
Other, net		(8,511)	(2,203)	(10,714)
Net cash used in investing activities from continuing operations		(424,482)	(248,294)	(672,776)
<b>Financing activities:</b>				
Treasury stock activity	(366,037)			(366,037)

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Payment of dividends to stockholders	(42,470)			(42,470)
Proceeds from exercise of equity awards	231,073		1,585	232,658
Transfers (to) from related parties	149,001	(149,001)		
Other, net	28,433	(2,746)	(3,765)	21,922
Net cash used in financing activities from continuing operations		(151,747)	(2,180)	(153,927)
<b>Net cash provided by (used in) continuing operations</b>		693,985	(66,780)	627,205
<b>Net cash used in discontinued operations</b>		(7,607)		(7,607)
Effect of exchange rate changes on cash and cash equivalents		5,863	133	5,996
<b>Net increase (decrease) in cash and cash equivalents</b>		692,241	(66,647)	625,594
Cash and cash equivalents at beginning of period		357,252	331,882	689,134
<b>Cash and cash equivalents at end of period</b>	\$	\$ 1,049,493	\$ 265,235	\$ 1,314,728

**Table of Contents****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****Nine months ended September 30, 2011**

	Parent	Guarantor Subsidiaries (In thousands)	Non- Guarantor Subsidiaries	Consolidated
<b>Operating activities:</b>				
Net cash provided by operating activities from continuing operations	\$	\$ 924,286	\$ 94,412	\$ 1,018,698
<b>Investing activities:</b>				
Capital expenditures, including internal-use software and website development		(140,897)	(16,970)	(157,867)
Purchases of investments		(1,111,613)	(67,942)	(1,179,555)
Sales and maturities of investments		973,476	72,919	1,046,395
Other, net		(8,117)	(7,037)	(15,154)
Net cash used in investing activities from continuing operations		(287,151)	(19,030)	(306,181)
<b>Financing activities:</b>				
Treasury stock activity	(208,693)			(208,693)
Payment of dividends to stockholders	(57,732)			(57,732)
Sales of additional interests in controlled subsidiaries, net			70,626	70,626
Transfers (to) from related parties	241,554	(241,554)		
Other, net	24,871	(3,888)	5,556	26,539
Net cash provided by (used in) financing activities from continuing operations		(245,442)	76,182	(169,260)
<b>Net cash provided by from continuing operations</b>		391,693	151,564	543,257
<b>Net cash provided by discontinued operations</b>		114,412		114,412
Effect of exchange rate changes on cash and cash equivalents		(14,950)	1,671	(13,279)
<b>Net increase in cash and cash equivalents</b>		491,155	153,235	644,390
Cash and cash equivalents at beginning of period		361,516	259,683	621,199
<b>Cash and cash equivalents at end of period</b>	\$	\$ 852,673	\$ 412,917	\$ 1,265,589

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

#### **Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the views of our management regarding current expectations and projections about future events and are based on currently available information. Actual results could differ materially from those contained in these forward-looking statements for a variety of reasons, including, but not limited to, those discussed in our Annual Report on Form 10-K for the year ended December 31, 2011, Part I, Item 1A, Risk Factors, as well as those discussed elsewhere in this report. Other unknown or unpredictable factors also could have a material adverse effect on our business, financial condition and results of operations. Accordingly, readers should not place undue reliance on these forward-looking statements. The use of words such as anticipates, estimates, expects, intends, plans and believes, among others, generally identify forward-looking statements; however, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. These forward-looking statements are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. We are not under any obligation to, and do not intend to, publicly update or review any of these forward-looking statements, whether as a result of new information, future events or otherwise, even if experience or future events make it clear that any expected results expressed or implied by those forward-looking statements will not be realized. Please carefully review and consider the various disclosures made in this report and in our other reports filed with the Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

The information included in this management's discussion and analysis of financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes included in this Quarterly Report, and the audited consolidated financial statements and notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2011.

#### **Overview**

Expedia, Inc. is an online travel company, empowering business and leisure travelers with the tools and information they need to efficiently research, plan, book and experience travel. We have created a global travel marketplace used by a broad range of leisure and corporate travelers, offline retail travel agents and travel service providers. We make available, on a stand-alone and package basis, travel products and services provided by numerous airlines, lodging properties, car rental companies, destination service providers, cruise lines and other travel product and service companies. We also offer travel and non-travel advertisers access to a potential source of incremental traffic and transactions through our various media and advertising offerings on our transaction-based websites.

Our portfolio of brands includes Expedia.com®, Hotels.com®, Hotwire.com™, Expedia Affiliate Network (EAN), Classic Vacations, Expedia Local Expert™, Expedia® CruiseShipCenters®, Egencia™, eLong™, and Venere Net SpA (Venere). In addition, many of these brands have related international points of sale. For additional information about our portfolio of brands, see Portfolio of Brands in Part I, Item 1, Business, in our Annual Report on Form 10-K for the year ended December 31, 2011.

On December 20, 2011, following the close of trading on the Nasdaq Stock Market, we completed the spin-off of TripAdvisor, Inc. (TripAdvisor), which consisted of the domestic and international operations previously associated with our TripAdvisor Media Group, to Expedia stockholders. We refer to this transaction as the spin-off. Immediately prior to the spin-off, Expedia effected a one-for-two reverse stock split.

All percentages within this section are calculated on actual, unrounded numbers.

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### ***Trends***

The travel industry, including offline agencies, online agencies and other suppliers of travel products and services, has historically been characterized by intense competition, as well as rapid and significant change. Generally, 2011 represented a year of gradual improvement for the travel industry. However, natural disasters, such as the earthquake and tsunami in Japan, political and social unrest in the Middle East and North Africa, the rising price of oil, and ongoing sovereign debt and economic issues in several European countries, all contribute to a somewhat uncertain forward environment for the travel industry.

### ***Online Travel***

Increased usage and familiarity with the internet have driven rapid growth in online penetration of travel expenditures. According to PhoCusWright, an independent travel, tourism and hospitality research firm, in 2011, approximately 54% of U.S. leisure, unmanaged and corporate travel expenditures occurred online, compared with approximately 39% of European travel. Online penetration in the Asia Pacific region is estimated to be over 20%, lagging behind that of Europe. These penetration rates have increased over the past few years, and are expected to continue growing. This significant growth has attracted many competitors to online travel. This competition has intensified in recent years, and the industry is expected to remain highly competitive for the foreseeable future. In addition to the growth of online travel agencies, airlines and lodging companies have aggressively pursued direct online distribution of their products and services, and supplier growth outpaced online agency growth for several years. Competitive entrants such as metasearch companies have in some cases been able to introduce differentiated features and content compared with the legacy online travel agency companies. In addition, models, such as daily deals and private sale sites have also begun proliferating. We have a number of daily deals offered on our retail websites as well as a partnership with Groupon called Groupon Getaways with Expedia. Finally, we have seen increased interest in the online travel industry from search engine companies as evidenced by recent innovations and proposed and actual acquisitions by companies such as Google and Microsoft.

The online travel industry has also seen the development of alternative business models and variations in the timing of payment by travelers and to suppliers, which in some cases place pressure on historical business models. In particular, the agency hotel model has seen rapid adoption in Europe. Expedia has both a merchant and an agency hotel offer for our hotel supply partners and we expect our use of these models to continue to evolve. During the quarter, Expedia continued introducing the Expedia Traveler Preference ( ETP ) program to hotel suppliers in the United States and Europe. ETP offers travelers the choice of whether to pay Expedia at the time of booking or pay the hotel at the time of stay.

Intense competition has also historically led to aggressive marketing spend by the travel suppliers and intermediaries, and a meaningful reduction in our overall marketing efficiencies and operating margins. We manage our selling and marketing spending on a brand basis at the local or regional level, making decisions in each market that we think are appropriate based on the relative growth opportunity, the expected returns and the competitive environment. In certain cases, we are pursuing and expect to continue to pursue long-term growth opportunities for which our marketing efficiency is lower than that for our consolidated business but for which we still believe the opportunity to be attractive. However, we believe that over the long-term we can manage our sales and marketing expense growth to be roughly in line with revenue growth.

### ***Hotel***

We generate the majority of our revenue through the marketing and distribution of hotel rooms (stand-alone and package bookings). Our relationships and negotiated economics with our hotel supply partners have remained broadly stable in the past few years. We have, however, implemented new customer loyalty and discount programs and have eliminated or reduced some fees in that timeframe and, as such, the margin of revenue we earn per booking has declined. Over the course of the last two years, occupancies and average daily rates ( ADRs ) in the lodging industry have generally improved in a gradually improving overall travel environment. Currently occupancy rates are near 2007 peaks, and there is very little new, net hotel supply being added in the U.S. lodging market with large chains focusing their development opportunities in international markets. This may help hoteliers with their objective of continuing to grow their ADRs and could lead to pressure in negotiations with hoteliers and may ultimately lead to pressure on terms for us and our OTA competitors. In international markets, hotel supply is being added at a much faster rate as hotel owners and operators try to take advantage of opportunities in faster growing regions such as China and India, among others. We have had success adding supply to our

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marketplace with over 160,000 hotels as of the end of the third quarter of 2012 representing growth in our direct relationships with hoteliers of 14% year-over-year. In addition, our room night growth has been healthy, with room nights growing 14% in 2010, 18% in 2011 and 25% for the first nine months of 2012. ADRs for rooms booked on Expedia sites grew 1% in 2010 and 5% in 2011, while they declined 2% for the first nine months of 2012.

### ***Air***

The airline sector in particular has historically experienced significant turmoil. In recent years, there has been increased air carrier consolidation, generally resulting in lower overall capacity and higher fares. In addition, air carriers have made significant efforts to keep seat capacity relatively low in order to ensure that demand for seats remains high and that flights are as full as possible. Reduced seating capacities are generally negative for Expedia as there is less air supply available on our websites, and in turn less opportunity to facilitate hotel rooms, car rental and other services on behalf of air travelers. Ticket prices on Expedia sites grew 11% in 2011 and 4% in the first nine months of 2012. We are encountering significant pressure on air remuneration as certain supply agreements renew, and as air carriers and global distribution system ( GDS ) intermediaries re-negotiate their long-term agreements. In addition, some U.S. air carriers introduced various incentives for customers to book directly with the carrier versus via online travel agencies. Examples of these incentives include lower fees, advance seat assignments and greater earning potential for frequent flier miles.

In part as a result of sharply rising average ticket prices, our ticket volumes decreased by 8% in 2011 after having grown by 11% in 2010. Air ticket volumes grew 6% in the first nine months of 2012, largely due to the acquisition of VIA Travel and air ticket sales of a major U.S. carrier, which were absent in the first quarter of 2011 due to a commercial disagreement.

From a product perspective, over 74% of our revenue comes from transactions involving the booking of hotel reservations, with approximately 8% of our revenue derived from the sale of airline tickets. We believe that the hotel product is the most profitable of the products we distribute and represents our best overall growth opportunity.

### ***Growth Strategy***

*Product Innovation.* Each of our leading brands was a pioneer in online travel and has been responsible for driving key innovations in the space over the past two decades. They each operate a dedicated technology team, which drives innovations that make researching and shopping for travel increasingly easier and helps customers find and book the best possible travel options. In the past several years, we made key investments in technology, including significant development of our technological platforms that makes it possible for us to deliver innovations at a faster pace. For example, we launched our new Hotels.com global platform in the first quarter of 2010, enabling us to significantly increase the innovation cycle for that brand. Since then, we have been successful in improving conversion and driving much faster growth rates for the Hotels.com brand. We are in the midst of a similar transformation for our Expedia brand, having rolled out its new hotel platform in the second half of 2011, followed by the air platform rollout during the first half of 2012, with expectations that the new package platform will be launched late in 2012 or early 2013.

*Global Expansion.* Our Expedia, Hotels.com, Egencia, EAN, and Hotwire brands operate both domestically and through international points of sale, including in Europe, Asia Pacific, Canada and Latin America. We own a majority share of eLong, which is the second largest online travel company in China. We also own Venere, a European brand, which focuses on marketing hotel rooms in Europe. Egencia, our corporate travel business, operates in 54 countries around the world and continues to expand aggressively, including its recent acquisition of VIA Travel, a travel management company in the Nordics. We also partner in a 50/50 joint venture with AirAsia – a low cost carrier serving the Asia-Pacific region to jointly grow an online travel agency business. Although the results for the joint venture are not consolidated in our financial statements, we consider this business to be a key part of our Asia Pacific strategy. In 2011, approximately 39% of our worldwide gross bookings and 42% of worldwide revenue were international up from 22% for both worldwide gross bookings and revenue in 2005. For the first nine months of 2012, 40% of our gross bookings and 43% of our revenue were international. We have a stated goal of driving more than half of our gross bookings and revenue through international points of sale.

In expanding our global reach, we leverage significant investments in technology, operations, brand building, supplier relationships and other initiatives that we have made since the launch of Expedia.com in 1996. We intend to continue



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leveraging these investments when launching additional points of sale in new countries, introducing new website features, adding supplier products and services including new business model offerings, as well as proprietary and user-generated content for travelers.

Our scale of operations enhances the value of technology innovations we introduce on behalf of our travelers and suppliers. We believe that our size and scale affords the company the ability to negotiate competitive rates with our supply partners, provide breadth of choice and travel deals to our traveling customers through an increasingly larger supply portfolio and creates opportunities for new value added offers for our customers such as our loyalty programs. The size of Expedia's worldwide traveler base makes our sites an increasingly appealing channel for travel suppliers to reach customers. In addition, the sheer size of our user base and search query volume allows us to test new technology very quickly in order to determine which innovations are most likely to improve the travel research and booking process, and then roll those features out to our worldwide audience in order to drive improvements to conversion.

*New Channel Penetration.* Today, the vast majority of online travel bookings are generated through typical desktop and laptop computers. However, technological innovations and developments are creating new opportunities including travel bookings made through mobile devices. In the past few years, each of our brands made significant progress creating new mobile websites and mobile applications that are receiving strong reviews and solid download trends. We own a leading travel application company called Mobiata which is responsible for several top travel applications, such as FlightTrack, FlightTrack Pro and FlightBoard, and is now creating mobile applications for our Expedia brand, most recently launching the mobile Expedia Hotels application for both the iPhone and the iPad. We believe mobile bookings present an opportunity for incremental growth as they are typically completed within one day of the travel or stay which is a much shorter booking window than we have historically experienced via more traditional online booking methods. We are also working with suppliers on specific mobile offerings which can represent a unique value proposition and offer customers room nights for as much as a 50% discount from retail rates.

We also continue to conduct numerous experiments within the daily deals space. For example, our Expedia brand has an exclusive partnership with Groupon, Groupon Getaways with Expedia, where we work with suppliers to offer consumers deeply discounted travel opportunities on a limited basis. We believe this may also represent incremental travel bookings as it typically represents an impulse purchase compared to historical travel purchasing activity which tends to be a highly considered and deliberate transaction. Virtually all of our leisure brands have efforts related to the daily deals or deep discount space.

Many of our brands are also actively participating in Facebook, Twitter and other social channels and we anticipate the importance of these channels to consumers and to our industry to increase over time. It is our intention to grow our social efforts alongside this trend.

### ***Seasonality***

We generally experience seasonal fluctuations in the demand for our travel products and services. For example, traditional leisure travel bookings are generally the highest in the first three quarters as travelers plan and book their spring, summer and holiday travel. The number of bookings typically decreases in the fourth quarter. Because revenue in the merchant business is generally recognized when the travel takes place rather than when it is booked, revenue typically lags bookings by several weeks or longer. The seasonal revenue impact is exacerbated with respect to income by the more stable nature of our fixed costs. As a result, revenue and income are typically the lowest in the first quarter and highest in the third quarter. The continued growth of our international operations or a change in our product mix may influence the typical trend of the seasonality in the future.

### **Critical Accounting Policies and Estimates**

Critical accounting policies and estimates are those that we believe are important in the preparation of our consolidated financial statements because they require that we use judgment and estimates in applying those policies. We prepare our consolidated financial statements and accompanying notes in accordance with generally accepted accounting principles in the United States (GAAP). Preparation of the consolidated financial statements and accompanying notes requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure

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of contingent assets and liabilities as of the date of the consolidated financial statements as well as revenue and expenses during the periods reported. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from our estimates under different assumptions or conditions.

There are certain critical estimates that we believe require significant judgment in the preparation of our consolidated financial statements. We consider an accounting estimate to be critical if:

It requires us to make an assumption because information was not available at the time or it included matters that were highly uncertain at the time we were making the estimate; and

Changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

For additional information about our critical accounting policies and estimates, see the disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2011.

## **New Accounting Pronouncements**

For a discussion of new accounting pronouncements, see Note 2 – Summary of Significant Accounting Policies in the notes to the consolidated financial statements.

## **Occupancy Taxes**

We are currently involved in 44 lawsuits brought by or against states, cities and counties over issues involving the payment of hotel occupancy taxes. We continue to defend these lawsuits vigorously. With respect to the principal claims in these matters, we believe that the ordinances at issue do not apply to the services we provide, namely the facilitation of hotel reservations, and, therefore, that we do not owe the taxes that are claimed to be owed. We believe that the ordinances at issue generally impose occupancy and other taxes on entities that own, operate or control hotels (or similar businesses) or furnish or provide hotel rooms or similar accommodations.

Recent developments include:

*Columbus-Findlay, Ohio Litigation.* The U.S. Sixth Circuit Court of Appeals affirmed the district court's decision dismissing all claims against the online travel companies and upheld the lower court's decision that the online travel companies have no obligation to collect and remit hotel occupancy taxes.

*Leon County v. Expedia, Inc., Florida Department of Revenue Litigation.* The court granted the online travel companies' and the Florida Department of Revenue's motions for summary judgment dismissing all claims in the case and held that the online travel companies have no obligation to collect and remit hotel occupancy taxes.

*District of Columbia Litigation.* The court granted in part and denied in part the District of Columbia's motion for summary judgment and denied the online travel companies' motions for summary judgment.

*Hawaii Tax Court Litigation.* The court granted the defendant online travel companies' motion for summary judgment, denied the State of Hawaii's motion and held that Transient Accommodation Taxes are not due on the online travel companies' services.

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*Kalamazoo County, Michigan Litigation.* Kalamazoo County, Michigan brought suit against a number of online travel companies, including Expedia and Hotels.com, alleging violation of a local tax ordinance and common law claims.

For additional information on these and other legal proceedings, see Part II, Item 1, Legal Proceedings.

We have established a reserve for the potential settlement of issues related to hotel occupancy tax litigation, consistent with applicable accounting principles and in light of all current facts and circumstances, in the amount of \$36 million as of September 30, 2012, which includes amounts expected to be paid in connection with the developments described above, and \$32 million as of December 31, 2011. In addition, as of December 31, 2011, we also accrued \$10 million related to court decisions and the potential and final settlement of issues related to hotel occupancy taxes.

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Certain jurisdictions may require us to pay tax assessments, including occupancy tax assessments, prior to contesting any such assessments. This requirement is commonly referred to as pay-to-play. Payment of these amounts is not an admission by the taxpayer that it believes it is subject to such taxes. During 2009, we expensed \$48 million related to monies paid in advance of litigation in occupancy tax proceedings in the city of San Francisco. During 2010, we expensed \$3 million related to monies paid in advance of litigation in occupancy tax proceedings in the city of Santa Monica; these funds were returned to us by the city in December 2011 in exchange for a letter of credit. We do not believe that the amounts we retain as compensation are subject to the cities' hotel occupancy tax ordinances. If we prevail in the litigation, for which a pay-to-play payment was made, the jurisdiction collecting the payment will be required to repay such amounts, plus interest. However, any significant pay-to-play payment or litigation loss could negatively impact our liquidity.

In addition, certain jurisdictions, including the states of New York, North Carolina and Minnesota, the city of New York, and the District of Columbia, have enacted legislation seeking to tax online travel company services as part of sales taxes for hotel occupancy. We are currently remitting taxes to the city of New York, the state of New York, the state and local jurisdictions of South Carolina, the State of Minnesota, and the city of Atlanta, Georgia.

## Segments

We have two reportable segments: Leisure, and Egencia. We determined our segments based on how our chief operating decision makers manage our business, make operating decisions and evaluate operating performance.

Our Leisure segment provides a full range of travel and advertising services to our worldwide customers through a variety of brands including: Expedia.com and Hotels.com in the United States and localized Expedia and Hotels.com websites throughout the world, EAN, Hotwire.com, Venere, eLong and Classic Vacations. Our Egencia segment provides managed travel services to corporate customers in North America, Europe, and the Asia Pacific region.

## Operating Metrics

Our operating results are affected by certain metrics, such as gross bookings and revenue margin, which we believe are necessary for understanding and evaluating us. Gross bookings represent the total retail value of transactions booked for both agency and merchant transactions, recorded at the time of booking reflecting the total price due for travel by travelers, including taxes, fees and other charges, and are generally reduced for cancellations and refunds. As travelers have increased their use of the internet to book travel arrangements, we have generally seen our gross bookings increase, reflecting the growth in the online travel industry, our organic market share gains and our business acquisitions. Revenue margin is defined as revenue as a percentage of gross bookings.

### Gross Bookings and Revenue Margin

	Three months ended September 30, 2012      2011 (\$ in millions)			Nine months ended September 30, 2012      2011 (\$ in millions)		
			% Change			% Change
<b><u>Gross Bookings</u></b>						
Leisure	\$ 8,120	\$ 6,956	17%	\$ 23,804	\$ 20,879	14%
Egencia	936	667	40%	2,630	1,993	32%
Total gross bookings	\$ 9,056	\$ 7,623	19%	\$ 26,434	\$ 22,872	16%
<b><u>Revenue Margin</u></b>						
Leisure	13.8%	14.0%		12.0%	12.1%	
Egencia	8.3%	6.6%		7.8%	6.7%	
Total revenue margin	13.2%	13.4%		11.6%	11.6%	

The increase in worldwide gross bookings for the three and nine months ended September 30, 2012, as compared to the same periods in 2011, was primarily due to a 27% and 25% increase in hotel room nights and a 11% and 6% increase in air tickets.

Revenue margin decreased for the three months ended September 30, 2012, as compared to the same period in 2011, primarily due to hotel product mix, lower net air supplier economics combined with higher air ticket prices and book-to-stay timing, partially offset by a favorable mix

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shift to our higher margin product. Revenue margin was largely consistent for the nine months ended September 30, 2012, as compared to the same period in 2011.

**Table of Contents****Results of Operations****Revenue**

	Three months ended September 30, 2012      2011			Nine months ended September 30, 2012      2011		
			% Change			% Change
	(\$ in millions)			(\$ in millions)		
Revenue by Segment						
Leisure	\$ 1,121	\$ 976	15%	\$ 2,849	\$ 2,528	13%
Egencia	78	44	76%	206	134	54%
Total revenue	\$ 1,199	\$ 1,020	17%	\$ 3,055	\$ 2,662	15%

Revenue increased for the three and nine months ended September 30, 2012, compared to the same periods in 2011, primarily due to an increase in hotel room nights stayed, partially offset by a decrease in revenue per room night and revenue per ticket. Egencia's acquisition of VIA Travel in the second quarter of 2012 added approximately 3% to year-over-year growth to total revenue for the three months ended September 30, 2012 and approximately 2% for the nine months ended September 30, 2012.

Worldwide hotel revenue increased 20% and 18% for the three and nine months ended September 30, 2012, compared to the same periods in 2011. The increase was primarily due to a 27% and 25% increase in room nights stayed, partially offset by a 6% and 5% decrease in revenue per room night for the respective periods. Revenue per room night decreased primarily due to changes in our hotel product mix, of which mix shift to regions with lower hotel economics is becoming a significant component, as well as impacts from foreign currency and accruals for loyalty programs.

Worldwide air revenue decreased 10% and 12% for the three and nine months ended September 30, 2012, compared to the same periods in 2011, due to a 19% and 17% decrease in revenue per air ticket, partially offset by an 11% and 6% increase in air tickets sold. The increase in air tickets sold primarily relates to the VIA Travel acquisition and was partially offset by volume pressure associated with a 1% and 4% increase in average ticket prices for the periods. In addition, the year-over-year increase for air tickets sold for nine months ended September 30, 2012 was also due to the availability of American Airlines tickets in the current year that were not available to our leisure consumers during the first quarter of 2011. Revenue per air ticket declined for both the quarterly and year-to-date periods due to lower net supplier economics and impacts from foreign exchange. The decline in the three months ended September 30, 2012 was also impacted by fewer consumer and interline booking fees while the decline in the nine months ended September 30, 2012 was partially offset by increases in those fees.

The remaining worldwide revenue, other than hotel and air discussed above, increased by 23% and 18% for the three and nine months ended September 30, 2012, compared to the same periods in 2011, primarily through strong growth in corporate travel fees primarily due to the VIA travel acquisition as well as an increase in advertising and media, insurance and car revenue.

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In addition to the above segment and product revenue discussion, our revenue by business model is as follows:

	Three months ended September 30, 2012      2011      % Change			Nine months ended September 30, 2012      2011      % Change		
	(\$ in millions)			(\$ in millions)		
<b>Revenue by Business Model</b>						
Merchant	\$ 929	\$ 777	20%	\$ 2,319	\$ 1,982	17%
Agency	235	216	8%	638	597	7%
Advertising and media	35	27	28%	98	83	18%
Total revenue	\$ 1,199	\$ 1,020	17%	\$ 3,055	\$ 2,662	15%

Merchant revenue increased for the three and nine months ended September 30, 2012, compared to the same periods in 2011, due to the increase in merchant hotel revenue primarily driven by an increase in room nights stayed.

Agency revenue increased for the three and nine months ended September 30, 2012, compared to the same periods in 2011, primarily due to growth in our corporate travel business and agency hotel business, partially offset by a decline in agency air revenue.

## Cost of Revenue

	Three months ended September 30, 2012 2011 % Change (\$ in millions)			Nine months ended September 30, 2012 2011 % Change (\$ in millions)		
Customer operations	\$ 120	\$ 96	24%	\$ 330	\$ 273	21%
Credit card processing	80	69	17%	212	187	13%
Data center and other	44	41	11%	131	118	11%
<b>Total cost of revenue</b>	<b>\$ 244</b>	<b>\$ 206</b>	<b>18%</b>	<b>\$ 673</b>	<b>\$ 578</b>	<b>17%</b>
<b>% of revenue</b>	<b>20.3%</b>	<b>20.2%</b>		<b>22.0%</b>	<b>21.7%</b>	

Cost of revenue primarily consists of (1) customer operations, including our customer support and telesales as well as fees to air ticket fulfillment vendors, (2) credit card processing, including merchant fees, charge backs and fraud, and (3) other costs, primarily including data center costs to support our websites, destination supply, and stock-based compensation.

During the three and nine months ended September 30, 2012, the primary drivers of the increase in cost of revenue expense were higher credit card processing costs related to our merchant bookings growth as well as higher headcount and other customer service costs related to the VIA Travel acquisition and additional headcount to support our global customer operations, partially offset by lower debit card fees and an increase in credit card rebates.

## Selling and Marketing

	Three months ended September 30, 2012 2011 % Change (\$ in millions)			Nine months ended September 30, 2012 2011 % Change (\$ in millions)		
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Direct costs	\$ 402	\$ 318	26%	\$ 1,028	\$ 899	14%
Indirect costs	104	90	15%	299	261	15%
<b>Total selling and marketing</b>	<b>\$ 506</b>	<b>\$ 408</b>	<b>24%</b>	<b>\$ 1,327</b>	<b>\$ 1,160</b>	<b>14%</b>

% of revenue	42.2%	40.0%	43.4%	43.6%
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Selling and marketing expense primarily relates to direct costs, including traffic generation costs from search engines and internet portals, television, radio and print spending, private label and affiliate program commissions, public relations and other costs. The remainder of the expense relates to indirect costs, including personnel and related overhead in our global supply organization, Egencia and various Leisure brands and stock-based compensation costs.

Selling and marketing expenses increased \$98 million and \$167 million during the three and nine months ended September 30, 2012, compared to the same periods in 2011, driven by increases in affiliate marketing expenses at EAN, online marketing spend at Hotels.com and our Expedia brand, as well as higher personnel expenses driven by additional headcount across our supply organization and several brands.



**Table of Contents****Technology and Content**

	Three months ended September 30, 2012 2011 (\$ in millions)			Nine months ended September 30, 2012 2011 (\$ in millions)		
			% Change			% Change
Personnel and overhead	\$ 66	\$ 49	33%	\$ 191	\$ 145	31%
Depreciation and amortization of technology assets	31	22	41%	81	60	34%
Other	29	27	6%	79	73	9%
Total technology and content	\$ 126	\$ 98	28%	\$ 351	\$ 278	26%
% of revenue	10.5%	9.6%		11.5%	10.5%	

Technology and content expense includes product development and content expense, as well as information technology costs to support our infrastructure, back-office applications and overall monitoring and security of our networks, and is principally comprised of personnel and overhead, depreciation and amortization of technology assets including hardware, and purchased and internally developed software, and other costs including licensing and maintenance expense and stock-based compensation.

The increase of \$28 million and \$73 million in technology and content expense during the three and nine months ended September 30, 2012, compared to the same periods in 2011, was primarily due to increased personnel costs for additional headcount to support key technology projects for our Expedia brand, corporate technology function and supply organization as well as increased depreciation and amortization of technology assets.

**General and Administrative**

	Three months ended September 30, 2012 2011 (\$ in millions)			Nine months ended September 30, 2012 2011 (\$ in millions)		
			% Change			% Change
Personnel and overhead	\$ 56	\$ 49	15%	\$ 159	\$ 135	18%
Professional fees and other	29	30	(2%)	88	87	1%
Total general and administrative	\$ 85	\$ 79	8%	\$ 247	\$ 222	11%
% of revenue	7.1%	7.7%		8.1%	8.3%	

General and administrative expense consists primarily of personnel-related costs, including our executive leadership, finance, legal and human resource functions as well as fees for external professional services including legal, tax and accounting, and other costs including stock-based compensation.

The \$6 million and \$25 million increase in general and administrative expense during the three and nine months ended September 30, 2012, compared to the same periods in 2011, was primarily due to higher personnel expenses resulting from an increase in headcount, partially offset by lower consulting fees. In addition, the increase for the three months ended September 30, 2012 was also due in part to higher legal fees.

**Amortization of Intangible Assets**

Three months ended	Nine months ended
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	September 30, 2012      2011			September 30, 2012      2011		
	(\$ in millions)			(\$ in millions)		
			% Change			% Change
Amortization of intangible assets	\$ 9	\$ 6	70%	\$ 22	\$ 17	24%
% of revenue	0.8%	0.5%		0.7%	0.7%	

Amortization for the three and nine months ended September 30, 2012 increased compared to the same periods of 2011 due to amortization related to the VIA Travel acquisition. In addition, amortization for the nine months ended September 30, 2012 included an approximate \$2 million reduction related to a change in the estimated value of contingent purchase consideration for one of our prior acquisitions.

**Table of Contents*****Legal Reserves, Occupancy Tax and Other***

	Three months ended September 30, 2012    2011			Nine months ended September 30, 2012    2011		
	(\$ in millions)			(\$ in millions)		
Legal reserves, occupancy tax and other	\$ 2	\$ 14	(84%)	\$ 5	\$ 19	(72%)

Legal reserves, occupancy tax and other consists of changes in our reserves for court decisions and the potential and final settlement of issues related to hotel occupancy taxes, expenses recognized related to monies paid in advance of occupancy tax proceedings ( pay-to-play ) as well as certain other legal reserves.

Fluctuations during the three and nine months ended September 30, 2012, compared to the same periods in 2011, were primarily a result of the developments of certain occupancy tax litigation in the third quarter of 2011 and the corresponding impacts on our reserves.

***Operating Income***

	Three months ended September 30, 2012    2011			Nine months ended September 30, 2012    2011		
	(\$ in millions)			(\$ in millions)		
Operating income	\$ 227	\$ 209	9%	\$ 430	\$ 388	11%
% of revenue	18.9%	20.5%		14.1%	14.6%	

Operating income increased for the three and nine months ended September 30, 2012 but decreased as a percentage of revenue, compared to the same periods in 2011, primarily due to the growth in revenue, partially offset by increases in operating expenses in excess of revenue as described above.

***Interest Income and Expense***

	Three months ended September 30, 2012    2011			Nine months ended September 30, 2012    2011		
	(\$ in millions)			(\$ in millions)		
Interest income	\$ 8	\$ 6	34%	\$ 21	\$ 15	41%
Interest expense	(22)	(23)	(5%)	(65)	(68)	(4%)

Interest income increased for the three and nine months ended September 30, 2012, compared to the same periods in 2011, primarily due to higher average cash, cash equivalent and investment balances in the current year as well as a higher rate of return on those balances.

**Table of Contents*****Other, Net***

Other, net is comprised of the following:

	Three months ended September 30, 2012      2011      % Change			Nine months ended September 30, 2012      2011      % Change		
	(\$ in millions)			(\$ in millions)		
Foreign exchange rate gains (losses), net	\$ (8)	\$ 10	(177%)	\$ (12)	\$ (2)	520%
Equity gains (losses) of unconsolidated affiliates, and other		1	N/A	\$ (7)	\$	N/A
Total other, net	\$ (8)	\$ 11	(178%)	\$ (19)	\$ (2)	973%

***Provision for Income Taxes***

	Three months ended September 30, 2012      2011      % Change			Nine months ended September 30, 2012      2011      % Change		
	(\$ in millions)			(\$ in millions)		
Provision for income taxes	\$ 36	\$ 31	18%	\$ 70	\$ 67	5%
Effective tax rate	17.7%	15.1%		19.2%	20.0%	

We determine our provision for income taxes for interim periods using an estimate of our annual effective rate. We record any changes to the estimated annual rate in the interim period in which the change occurs, including discrete tax items.

Our effective tax rate was 17.7% and 19.2% for the three and nine months ended September 30, 2012, which was lower than the 35% federal statutory rate primarily due to estimated earnings in jurisdictions outside the United States, release of a valuation allowance related to foreign deferred tax assets, and to a lesser extent adjustments resulting from a reconciliation of the prior year's income tax return to our provision for income taxes, partially offset by state income taxes.

The increase in the effective rate for the three months ended September 30, 2012 as compared to the same period in 2011 was primarily due to a decrease in estimated earnings as a percentage of total earnings in jurisdictions outside of the United States, reserves for uncertain tax positions, and other nondeductible expenses and income inclusions, offset by the release of a valuation allowance on foreign deferred tax assets.

Our effective tax rate was 15.1% and 20.0% for the three and nine months ended September 30, 2011, which was lower than the 35% federal statutory rate primarily due to estimated earnings in jurisdictions outside the United States and to a lesser extent adjustments resulting from a reconciliation of the prior year's income tax return to our provision for income taxes, partially offset by state income taxes.

***Discontinued Operations, Net of Taxes***

During the nine months ended September 30, 2012, we incurred a loss from early extinguishment of our 8.5% senior notes due 2016 (the "8.5% Notes") resulting directly from the spin-off of TripAdvisor. The pre-tax loss was approximately \$38 million (or \$24 million net of tax), which included an early redemption premium of \$33 million and the write-off of \$5 million of unamortized debt issuance and discount costs. This loss was recorded within discontinued operations in the first quarter of 2012, as that was the period in which the 8.5% Notes were legally extinguished. For additional information, see Note 3 "Acquisitions and Dispositions" in the notes to the consolidated financial statements. Discontinued operations also includes the results of operations of TripAdvisor for the three and nine months ended September 30, 2011, the reclassification of expense related to the obligation to fund a charitable foundation that was assumed by TripAdvisor in conjunction with the spin-off as well as interest expense and amortization of debt issuance costs and discount related to 8.5% Notes which were redeemed in connection with the spin-off.

**Financial Position, Liquidity and Capital Resources**

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Our principal sources of liquidity are cash flows generated from operations; our cash and cash equivalents and short-term investment balances, which were \$2.4 billion and \$1.3 billion at September 30, 2012 and December 31, 2011, including \$300 million and \$302 million of cash and short-term investment balances of majority-owned subsidiaries as well as \$52

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million and \$131 million held in foreign subsidiaries related to earnings indefinitely invested outside the United States; and our \$750 million revolving credit facility. As of September 30, 2012, \$728 million was available under the facility representing the total \$750 million facility less \$22 million of outstanding stand-by letters of credit. The revolver provides capacity in excess of the outstanding 7.456% senior notes in the event of a partial or full redemption at the option of the holders in August 2013. The revolving credit facility bears interest based on the Company's credit ratings, with drawn amounts bearing interest at LIBOR plus 150 basis points, and the commitment fee on undrawn amounts at 22.5 basis points as of September 30, 2012.

Our credit ratings are periodically reviewed by rating agencies. In April 2011, in response to our announcement of the TripAdvisor spin-off, Moody's affirmed its Ba1 rating and changed its outlook from positive to stable, while S&P and Fitch placed the Company's ratings on Credit Watch with negative implications and Rating Watch Negative, respectively. In October 2011, Fitch affirmed its rating at BBB- and removed the rating from Rating Watch Negative, with an outlook of stable. In December 2011, S&P affirmed the Company's BBB- rating and removed the ratings from Credit Watch, with an outlook of stable. In October 2012, Fitch affirmed its rating at BBB- with an outlook of stable. Changes in our operating results, cash flows, or financial position could impact the ratings assigned by the various rating agencies. Should our credit ratings be adjusted downward, we may incur higher costs to borrow, which could have a material impact on our financial condition and results of operations.

Under the merchant model, we receive cash from travelers at the time of booking and we record these amounts on our consolidated balance sheets as deferred merchant bookings. We pay our airline suppliers related to these merchant model bookings generally within a few weeks after completing the transaction, but we are liable for the full value of such transactions until the flights are completed. For most other merchant bookings, which is primarily our merchant hotel business, we pay after the travelers' use and subsequent billing from the hotel suppliers. Therefore, generally we receive cash from the traveler prior to paying our suppliers, and this operating cycle represents a working capital source of cash to us. As long as the merchant hotel business grows, we expect that changes in working capital related to merchant hotel transactions will positively impact operating cash flows. However, we continue to evaluate the use of the merchant model versus the agency model in each of our markets. If the merchant hotel model declines relative to our other business models that generally consume working capital such as agency hotel, managed corporate travel or media, or if there are changes to the merchant model or booking patterns which compress the time of receipts of cash from travelers to payment to suppliers, our overall working capital benefits could be reduced, eliminated, or even reversed.

For example, we recently started introducing new technology to our hotel supply partners, which will enable closer integration of the agency hotel model with our core merchant offering in the United States and Europe. Depending on relative traveler and supplier adoption rates, among other things, the introduction of ETP could drive future impacts to working capital and cash flow over time.

Seasonal fluctuations in our merchant hotel bookings affect the timing of our annual cash flows. During the first half of the year, hotel bookings have traditionally exceeded stays, resulting in much higher cash flow related to working capital. During the second half of the year, this pattern reverses and cash flows are typically negative. While we expect the impact of seasonal fluctuations to continue, merchant hotel growth rates, changes to the model or booking patterns, as well as changes in the relative mix of merchant hotel transactions compared with transactions in our working capital consuming businesses, including ETP, may counteract or intensify the anticipated seasonal fluctuations.

As of September 30, 2012, we had a deficit in our working capital of \$207 million, compared to a deficit of \$279 million as of December 31, 2011.

We continue to invest in the development and expansion of our operations. Ongoing investments include but are not limited to improvements to infrastructure, which include our servers, networking equipment and software, release improvements to our software code, platform migrations and consolidation and search engine marketing and optimization efforts. Our future capital requirements may include capital needs for acquisitions, share repurchases, dividend payments or expenditures in support of our business strategy; thus reducing our cash balance and/or increasing our debt. Our capital expenditures for full year 2012 are expected to be above 2011 spending levels.

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Our cash flows are as follows:

	Nine months ended September 30,		
	2012	2011	\$ Change
	(In millions)		
Cash provided by (used in) continuing operations:			
Operating activities	\$ 1,454	\$ 1,019	\$ 435
Investing activities	(673)	(306)	(367)
Financing activities	(154)	(169)	15
Net cash provided by (used in) discontinued operations	(8)	114	(122)
Effect of foreign exchange rate changes on cash and cash equivalents	6	(13)	19

For the nine months ended September 30, 2012, net cash provided by operating activities increased by \$435 million primarily due to increased benefits from working capital changes as well as an increase in operating income.

For the nine months ended September 30, 2012, cash used in investing activities increased by \$367 million primarily due to an increase of cash used for acquisitions of \$190 million, higher net purchases of investments of \$154 million and higher capital expenditures of \$19 million.

Cash used in financing activities for the nine months ended September 30, 2012 primarily included cash paid to acquire shares of \$366 million, including the repurchased shares under the authorizations discussed below, as well as \$42 million cash dividend payments, partially offset by \$233 million of proceeds from the exercise of equity awards, including the warrants discussed below. Cash used in financing activities for the nine months ended September 30, 2011 primarily included cash paid to acquire shares of \$209 million as well as a \$58 million cash dividend payment, partially offset by a net \$71 million inflow related to the May 2011 eLong transaction and our purchase of additional interest in another subsidiary and \$23 million of proceeds from the exercise of equity awards.

In 2010, the Executive Committee, acting on behalf of the Board of Directors, authorized a repurchase of up to 20 million outstanding shares of our common stock. On April 25, 2012, the Executive Committee, acting on behalf of the Board of Directors, authorized an additional repurchase of up to 20 million outstanding shares of our common stock. During the nine months ended September 30, 2012 and 2011, we repurchased, through open market transactions, 9.9 million and 7.6 million shares (3.8 million on a reverse split adjusted basis) available under the authorizations for a total cost of \$351 million and \$199 million, excluding transaction costs. As of September 30, 2012, 18.9 million shares remain authorized for repurchase under the April 2012 authorization with no fixed termination date for the repurchases. Subsequent to the end of the third quarter of 2012, we repurchased an additional 0.8 million shares for a total cost of \$46 million, excluding transaction costs, representing an average purchase price of \$55.36 per share.

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In the first nine months of 2012 and 2011, the Executive Committee, acting on behalf of the Board of Directors, declared and we paid the following dividends:

<b>Declaration Date</b>	<b>Dividend Per Share</b>	<b>Record Date</b>	<b>Total Amount (in thousands)</b>	<b>Payment Date</b>
<b>Nine months ended September 30, 2012:</b>				
February 9, 2012	\$ 0.09	March 12, 2012	\$ 12,204	March 30, 2012
April 25, 2012	0.09	May 30, 2012	12,205	June 19, 2012
July 25, 2012	0.13	August 28, 2012	18,061	September 18, 2012
<b>Nine months ended September 30, 2011:</b>				
February 9, 2011	\$ 0.14	March 11, 2011	\$ 19,352	March 31, 2011
April 27, 2011	0.14	May 27, 2011	19,232	June 17, 2011
July 26, 2011	0.14	August 26, 2011	19,148	September 16, 2011

In addition, on October 24, 2012, the Executive Committee, acting on behalf of the Board of Directors, declared a quarterly cash dividend of \$0.13 per share of outstanding common stock payable on December 7, 2012 to stockholders of record as of the close of business on November 16, 2012. Future declarations of dividends are subject to final determination of our Board of Directors.

During the second quarter of 2012, we issued 7.3 million shares of Expedia, Inc. common stock as a result of the exercise of 30 million privately held warrants at a weighted average exercise price of \$23.98 for total proceeds to the Company of approximately \$175 million. As of September 30, 2012, we did not have any warrants outstanding.

The effect of foreign exchange on our cash balances denominated in foreign currency for the nine months ended September 30, 2012 showed a net increase of \$19 million reflecting higher foreign-denominated cash balances in the current year and appreciation in currencies.

In our opinion, available cash, funds from operations and available borrowings will provide sufficient capital resources to meet our foreseeable liquidity needs. There can be no assurance, however, that the cost or availability of future borrowings, including refinancings, if any, will be available on terms acceptable to us.

***Contractual Obligations, Commercial Commitments and Off-balance Sheet Arrangements***

There have been no material changes outside the normal course of business to our contractual obligations and commercial commitments since December 31, 2011. Other than our contractual obligations and commercial commitments, we did not have any off-balance sheet arrangements as of September 30, 2012 or December 31, 2011.

***Certain Relationships and Related Party Transactions***

For a discussion of certain relationships and related party transactions, including TripAdvisor, see Note 9 Related Party Transactions in the notes to the consolidated financial statements.



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**Part I. Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk Management**

There has been no material changes in our market risk during the three and nine months ended September 30, 2012. For additional information, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in Part II of our Annual Report on Form 10-K for the year ended December 31, 2011.

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**Part I. Item 4. Controls and Procedures**

***Evaluation of disclosure controls and procedures.***

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the Exchange Act), our management, including our Chairman and Senior Executive, Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon that evaluation, our Chairman and Senior Executive, Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

***Changes in internal control over financial reporting.***

There were no changes to our internal control over financial reporting that occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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### **Part II. Item 1. Legal Proceedings**

In the ordinary course of business, Expedia and its subsidiaries are parties to legal proceedings and claims involving property, personal injury, contract, alleged infringement of third party intellectual property rights and other claims. A discussion of certain legal proceedings can be found in the section titled "Legal Proceedings," of our Annual Report on Form 10-K for the year ended December 31, 2011 and our subsequent Quarterly Reports on Form 10-Q. The following are developments regarding such legal proceedings:

#### **Litigation Relating to Hotel Occupancy Taxes**

##### ***Actions Filed by Individual States, Cities and Counties***

*Columbus-Findlay, Ohio Litigation.* On September 10, 2012, the U.S. Sixth Circuit Court of Appeals affirmed the district court's decision dismissing all claims against the online travel companies and upheld the lower court's decision that the online travel companies have no obligation to collect and remit hotel occupancy taxes.

*Village of Rosemont, Illinois Litigation.* On July 31, 2012, the court granted in part and denied in part the parties' cross-motions for summary judgment on damages.

*Pine Bluff, Arkansas Litigation.* A hearing on plaintiffs' motion for class certification is scheduled for November 19, 2012.

*Leon County v. Expedia, Inc., Florida Department of Revenue Litigation.* On September 19, 2012, the court granted the online travel companies and the Florida Department of Revenue's motions for summary judgment dismissing all claims in the case and held that Leon County does not have the right to bring an action for collection of state sales tax.

*District of Columbia Litigation.* On September 24, 2012, the court granted in part the District of Columbia's motion on summary judgment and denied the online travel companies' motions on summary judgment.

*State of Mississippi Litigation.* On September 20, 2012, the court denied the online travel companies' motion to dismiss.

*Kalamazoo County, Michigan Litigation.* On August 23, 2012, Kalamazoo County, Michigan brought suit against a number of online travel companies, including Expedia and Hotels.com. *County of Kalamazoo, Michigan v. Hotels.com L.P., et al.*, Case No. 2012-0450-CZ (Ninth Judicial Circuit Court, County of Kalamazoo, Michigan). The complaint includes claims for declaratory judgment, injunctive relief, violation of local tax ordinance, conversion, unjust enrichment, constructive trust, money had and received and joint venture liability.

##### ***Notices of Audit or Tax Assessments***

At various times, the Company has also received notices of audit, or tax assessments from municipalities and other taxing jurisdictions concerning our possible obligations with respect to state and local hotel occupancy or related taxes, which are listed in the section titled "Legal Proceedings" of our Annual Report on Form 10-K for the year ended December 31, 2011 and subsequent Quarterly Reports on Form 10-Q.

The Company believes that the claims discussed above lack merit and will continue to defend vigorously against them.

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**Part II. Item 1. Legal Proceedings**

***Actions Filed by Expedia***

*Hawaii Tax Court Litigation.* On August 31, 2012, Expedia, Hotels.com, Hotwire and other online travel companies and the Hawaii Director of Taxation filed cross motions for summary judgment. A hearing on those motions was held on October 22, 2012. The court granted the defendant online travel companies' motion for summary judgment, denied the State of Hawaii's motion and held that Transient Accommodation Taxes are not due on the online travel companies' services.

*City of Portland Litigation.* On August 29, 2012, the online travel companies filed a motion to dismiss the city and county's common law counterclaims that online travel companies are required to collect and remit hotel occupancy taxes.

**Matters Relating to Hotel Booking Practices**

On July 31, 2012, the United Kingdom Office of Fair Trading (OFT) issued a Statement of Objections alleging that Expedia, Booking.com B.V. and InterContinental Hotels Group PLC (IHG) have infringed European Union and United Kingdom competition law in relation to the online supply of hotel room accommodations. The Statement of Objections alleges that Expedia and Booking.com entered into separate agreements with IHG that restricted each online travel company's ability to discount the price of IHG hotel rooms. The OFT limited its investigation to a small number of companies, but has stated that the investigation is likely to have wider implications for the industry within the United Kingdom.

The Statement of Objections does not constitute a finding of infringement and all parties have the opportunity to respond. If the OFT maintains its objections after the companies' responses, the OFT can issue a final decision. In such a case a final decision would be issued at the earliest in 2013. An appeal of an adverse OFT decision is to the English courts but may involve a reference on matters of European Union law to the European Court of Justice. We are unable at this time to predict the outcome of the OFT proceeding and any appeal. In addition, a number of competition authorities in other European countries have initiated investigations in relation to certain contractual arrangements between hotels and online travel companies, including Expedia. These investigations differ in relation to the parties involved and the precise nature of the concerns.

Since August 20, 2012, twenty-one putative class action lawsuits, which refer to the OFT's Statement of Objections, have been initiated in the United States by consumer plaintiffs alleging claims against the online travel companies, including Expedia, and several major hotel chains for alleged resale price maintenance for online hotel room reservations, including but not limited to violation of the Sherman Act, state antitrust laws, state consumer protection statutes and common law tort claims, such as unjust enrichment. The cases are currently pending in multiple federal and state courts. The parties have moved before the Judicial Panel on Multi-District Litigation for consolidation of the cases.

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**Part II. Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described below and in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Table of Contents****Part II. Item 2. Unregistered Sales of Equity Securities and Use of Proceeds*****Share Repurchases***

In 2010, the Executive Committee, acting on behalf of the Board of Directors, authorized a repurchase of up to 20 million outstanding shares of our common stock. On April 25, 2012, the Executive Committee, acting on behalf of the Board of Directors, authorized an additional repurchase of up to 20 million outstanding shares of our common stock. During the nine months ended September 30, 2012, we repurchased, through open market transactions, 9.9 million under the authorizations for a total cost of \$351 million, excluding transaction costs. As of September 30, 2012, 18.9 million shares remain authorized for repurchase under the April 2012 authorization. There is no fixed termination date for the repurchases.

A summary of the repurchase activity for the third quarter of 2012 is as follows:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under Plans or Programs</b>
		(In thousands, except per share data)		
July 1-31 2012		\$		20,000
August 1-31, 2012	213	52.34	213	19,787
September 1-30, 2012	882	54.95	882	18,905
Total	1,095	\$ 54.44	1,095	

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**Part II. Item 6. Exhibits**

The exhibits listed below are filed as part of this Quarterly Report on Form 10-Q.

Exhibit		Filed	Incorporated by Reference				Filing
No.	Exhibit Description	Herewith	Form	SEC File No.	Exhibit		Date
31.1	Certification of the Chairman and Senior Executive pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X					
31.2	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X					
31.3	Certification of the Chief Financial Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002	X					
32.1	Certification of the Chairman and Senior Executive pursuant Section 906 of the Sarbanes-Oxley Act of 2002	X					
32.2	Certification of the Chief Executive Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002	X					
32.3	Certification of the Chief Financial Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002	X					
101*	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL: (i) Consolidated Statements of Operations, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.						

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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 hereunto duly authorized.

October 25, 2012

Expedia, Inc.

By: /s/ MARK D. OKERSTROM  
Mark D. Okerstrom  
Chief Financial Officer