

Expedia, Inc.  
Form 10-Q  
November 08, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

**For the quarterly period ended September 30, 2007**

**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)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-2705720**

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

**3150 139<sup>th</sup> Avenue SE  
Bellevue, WA 98005**

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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 26, 2007 was:

|                                                   |                    |
|---------------------------------------------------|--------------------|
| Common stock, \$0.001 par value per share         | 258,901,117 shares |
| Class B common stock, \$0.001 par value per share | 25,599,998 shares  |

**Expedia, Inc.**  
**Form 10-Q**  
**For the Quarter Ended September 30, 2007**  
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**EXPEDIA, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except per share data)  
(Unaudited)

|                                                                      | Three months ended<br>September 30, |                  | Nine months ended<br>September 30, |                   |
|----------------------------------------------------------------------|-------------------------------------|------------------|------------------------------------|-------------------|
|                                                                      | 2007                                | 2006             | 2007                               | 2006              |
| Revenue                                                              | \$ 759,596                          | \$ 613,942       | \$ 2,000,030                       | \$ 1,706,298      |
| Cost of revenue (1)                                                  | 151,053                             | 133,094          | 415,997                            | 380,857           |
| Gross profit                                                         | 608,543                             | 480,848          | 1,584,033                          | 1,325,441         |
| Operating expenses:                                                  |                                     |                  |                                    |                   |
| Selling and marketing (1)                                            | 279,341                             | 215,086          | 757,514                            | 614,778           |
| General and administrative (1)                                       | 83,365                              | 66,156           | 235,261                            | 210,570           |
| Technology and content (1)                                           | 47,452                              | 36,034           | 131,215                            | 104,866           |
| Amortization of intangible assets                                    | 18,613                              | 26,569           | 59,312                             | 86,860            |
| Impairment of intangible asset                                       |                                     | 47,000           |                                    | 47,000            |
| Amortization of non-cash distribution and marketing                  |                                     | 711              |                                    | 9,578             |
| Operating income                                                     | 179,772                             | 89,292           | 400,731                            | 251,789           |
| Other income (expense):                                              |                                     |                  |                                    |                   |
| Interest income                                                      | 12,888                              | 9,697            | 30,709                             | 20,332            |
| Interest expense                                                     | (13,940)                            | (4,857)          | (35,018)                           | (7,230)           |
| Other, net                                                           | (13,894)                            | 2,926            | (13,453)                           | 17,049            |
| Total other income (expense), net                                    | (14,946)                            | 7,766            | (17,762)                           | 30,151            |
| Income before income taxes and minority interest                     | 164,826                             | 97,058           | 382,969                            | 281,940           |
| Provision for income taxes                                           | (65,542)                            | (37,707)         | (153,230)                          | (103,523)         |
| Minority interest in (income) loss of consolidated subsidiaries, net | 311                                 | (374)            | 768                                | (623)             |
| <b>Net income</b>                                                    | <b>\$ 99,595</b>                    | <b>\$ 58,977</b> | <b>\$ 230,507</b>                  | <b>\$ 177,794</b> |
| <b>Net earnings per share available to common stockholders:</b>      |                                     |                  |                                    |                   |
| Basic                                                                | \$ 0.34                             | \$ 0.18          | \$ 0.77                            | \$ 0.52           |
| Diluted                                                              | 0.32                                | 0.17             | 0.72                               | 0.50              |
| <b>Shares used in computing earnings per share:</b>                  |                                     |                  |                                    |                   |
| Basic                                                                | 292,171                             | 330,359          | 300,959                            | 340,660           |

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|                                                   |           |           |           |           |
|---------------------------------------------------|-----------|-----------|-----------|-----------|
| Diluted                                           | 312,756   | 341,137   | 318,848   | 355,075   |
| (1) Includes stock-based compensation as follows: |           |           |           |           |
| Cost of revenue                                   | \$ 550    | \$ 1,816  | \$ 2,079  | \$ 6,627  |
| Selling and marketing                             | 2,729     | 2,968     | 8,768     | 11,665    |
| General and administrative                        | 7,683     | 7,043     | 22,356    | 25,483    |
| Technology and content                            | 3,455     | 4,612     | 11,046    | 13,772    |
| Total stock-based compensation                    | \$ 14,417 | \$ 16,439 | \$ 44,249 | \$ 57,547 |

*See accompanying notes.*

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**EXPEDIA, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

|                                                                        | September<br>30,<br>2007<br>(Unaudited) | December<br>31,<br>2006 |
|------------------------------------------------------------------------|-----------------------------------------|-------------------------|
| <b>ASSETS</b>                                                          |                                         |                         |
| Current assets:                                                        |                                         |                         |
| Cash and cash equivalents                                              | \$ 836,531                              | \$ 853,274              |
| Restricted cash and cash equivalents                                   | 20,748                                  | 11,093                  |
| Accounts and notes receivable, net of allowance of \$5,226 and \$4,874 | 317,901                                 | 211,430                 |
| Prepaid merchant bookings                                              | 71,986                                  | 39,772                  |
| Deferred income taxes, net                                             | 275                                     | 4,867                   |
| Prepaid expenses and other current assets                              | 71,279                                  | 62,249                  |
| Total current assets                                                   | 1,318,720                               | 1,182,685               |
| Property and equipment, net                                            | 152,941                                 | 137,144                 |
| Long-term investments and other assets                                 | 89,006                                  | 59,289                  |
| Intangible assets, net                                                 | 988,525                                 | 1,028,774               |
| Goodwill                                                               | 5,912,934                               | 5,861,292               |
| <b>TOTAL ASSETS</b>                                                    | <b>\$ 8,462,126</b>                     | <b>\$ 8,269,184</b>     |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|                             |            |            |
|-----------------------------|------------|------------|
| Current liabilities:        |            |            |
| Accounts payable, merchant  | \$ 823,351 | \$ 600,192 |
| Accounts payable, other     | 185,868    | 120,545    |
| Deferred merchant bookings  | 818,474    | 466,474    |
| Deferred revenue            | 13,765     | 10,317     |
| Income taxes payable        | 52,522     | 30,902     |
| Other current liabilities   | 196,858    | 171,695    |
| Total current liabilities   | 2,090,838  | 1,400,125  |
| Long-term debt              | 500,000    | 500,000    |
| Credit facility             | 500,000    |            |
| Deferred income taxes, net  | 362,398    | 369,297    |
| Other long-term liabilities | 104,052    | 33,716     |
| Minority interest           | 62,590     | 61,756     |

Commitments and contingencies

Stockholders' equity:

Preferred stock \$.001 par value

Authorized shares: 100,000,000

Series A shares issued and outstanding: 776 and 846

Common stock \$.001 par value

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|                                                                           |                     |                     |
|---------------------------------------------------------------------------|---------------------|---------------------|
| Authorized shares: 1,600,000,000                                          |                     |                     |
| Shares issued: 332,539,633 and 328,066,276                                |                     |                     |
| Shares outstanding: 255,005,709 and 305,901,048                           | 333                 | 328                 |
| Class B common stock \$.001 par value                                     |                     |                     |
| Authorized shares: 400,000,000                                            |                     |                     |
| Shares issued and outstanding: 25,599,998 and 25,599,998                  | 26                  | 26                  |
| Additional paid-in capital                                                | 5,996,099           | 5,903,200           |
| Treasury stock    Common stock, at cost Shares: 77,533,924 and 22,165,228 | (1,717,922)         | (321,155)           |
| Retained earnings                                                         | 536,847             | 309,912             |
| Accumulated other comprehensive income                                    | 26,865              | 11,979              |
| Total stockholders' equity                                                | 4,842,248           | 5,904,290           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                         | <b>\$ 8,462,126</b> | <b>\$ 8,269,184</b> |

*See accompanying notes.*

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**EXPEDIA, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

|                                                                                                     | Nine months ended<br>September 30, |                 |
|-----------------------------------------------------------------------------------------------------|------------------------------------|-----------------|
|                                                                                                     | 2007                               | 2006            |
| <b>Operating activities:</b>                                                                        |                                    |                 |
| Net income                                                                                          | \$ 230,507                         | \$ 177,794      |
| Adjustments to reconcile net income to net cash provided by operating activities:                   |                                    |                 |
| Depreciation                                                                                        | 43,381                             | 35,834          |
| Amortization of intangible assets, non-cash distribution and marketing and stock-based compensation | 103,561                            | 153,985         |
| Deferred income taxes                                                                               | (3,297)                            | (31,702)        |
| Unrealized (gain) loss on derivative instruments, net                                               | 5,938                              | (11,609)        |
| Equity in (income) loss of unconsolidated affiliates                                                | 3,848                              | (2,331)         |
| Minority interest in income (loss) of consolidated subsidiaries, net                                | (768)                              | 623             |
| Impairment of intangible asset                                                                      |                                    | 47,000          |
| Foreign exchange gain on cash and cash equivalents, net                                             | (18,669)                           | (23,274)        |
| Other                                                                                               | 3,362                              | 785             |
| Changes in operating assets and liabilities, net of effects from acquisitions:                      |                                    |                 |
| Accounts and notes receivable                                                                       | (94,431)                           | (39,767)        |
| Prepaid merchant bookings and prepaid expenses                                                      | (38,674)                           | (30,178)        |
| Accounts payable, other and other current liabilities                                               | 154,180                            | 103,189         |
| Accounts payable, merchant                                                                          | 221,084                            | 122,307         |
| Deferred merchant bookings                                                                          | 351,969                            | 216,911         |
| Deferred revenue                                                                                    | 3,365                              | 4,001           |
| <b>Net cash provided by operating activities</b>                                                    | <b>965,356</b>                     | <b>723,568</b>  |
| <b>Investing activities:</b>                                                                        |                                    |                 |
| Capital expenditures                                                                                | (57,620)                           | (67,580)        |
| Acquisitions, net of cash acquired                                                                  | (59,622)                           | (29,830)        |
| Increase in long-term investments and deposits                                                      | (29,677)                           | (1,820)         |
| <b>Net cash used in investing activities</b>                                                        | <b>(146,919)</b>                   | <b>(99,230)</b> |
| <b>Financing activities:</b>                                                                        |                                    |                 |
| Credit facility borrowings                                                                          | 650,000                            |                 |
| Credit facility repayments                                                                          | (150,000)                          | (230,649)       |
| Proceeds from issuance of long-term debt, net of issuance costs                                     |                                    | 495,682         |
| Changes in restricted cash and cash equivalents                                                     | (10,630)                           | (2,604)         |
| Proceeds from exercise of equity awards                                                             | 45,398                             | 29,360          |
| Excess tax benefit on equity awards                                                                 | 2,676                              | 781             |
| Treasury stock activity                                                                             | (1,396,012)                        | (295,105)       |
| Other, net                                                                                          | (844)                              |                 |

|                                                              |            |            |
|--------------------------------------------------------------|------------|------------|
| <b>Net cash used in financing activities</b>                 | (859,412)  | (2,535)    |
| Effect of exchange rate changes on cash and cash equivalents | 24,232     | 26,473     |
| <b>Net increase (decrease) in cash and cash equivalents</b>  | (16,743)   | 648,276    |
| Cash and cash equivalents at beginning of period             | 853,274    | 297,416    |
| <b>Cash and cash equivalents at end of period</b>            | \$ 836,531 | \$ 945,692 |
| <b>Supplemental cash flow information</b>                    |            |            |
| Cash paid for interest                                       | \$ 41,381  | \$ 3,796   |
| Income tax payments, net                                     | 69,751     | 63,955     |
| <i>See accompanying notes.</i>                               |            |            |

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**Notes to Consolidated Financial Statements**  
**September 30, 2007**  
**(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. These travel products and services are offered through a diversified portfolio of brands including: Expedia.com®, Hotels.com®, Hotwire.com™, our private label programs (Worldwide Travel Exchange and Interactive Affiliate Network), Classic Vacations, Expedia® Corporate Travel ( ECT ), eLong Inc. ( eLong ) and TripAdvisor®. 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 in these consolidated financial statements.

***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 future 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, 2006, previously filed with the Securities and Exchange Commission ( SEC ).

***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 long-lived and intangible assets and goodwill, income taxes, potential settlements related to occupancy taxes, stock-based compensation and accounting for derivative instruments.

***Reclassifications***

We have reclassified prior period financial statements to conform to the current period presentation.

In our consolidated statement of cash flows for the nine months ended September 30, 2006, we reclassified net foreign exchange gains and losses on cash of U.S. functional subsidiaries held in foreign currencies from operating cash flows to effect of exchange rate changes on cash and cash equivalents to appropriately reflect foreign currency impacts on cash and cash equivalents for the periods presented.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)*****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 of the year 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. As a result, revenue is typically the lowest in the first quarter and highest in the third quarter.

**Note 2 Summary of Significant Accounting Policies*****Income Taxes***

In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*, we record income taxes under the liability method. Deferred tax assets and liabilities reflect our estimate of the future tax consequences of temporary differences between the carrying amounts of assets and liabilities for book and tax purposes. We determine deferred income taxes based on the differences in accounting methods and timing between financial statement and income tax reporting. Accordingly, we determine the deferred tax asset or liability for each temporary difference based on the enacted tax rates in effect for the years in which we expect to realize the underlying items of income and expense. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent earnings experience by jurisdiction, expectations of future taxable income, and the carryforward periods available to us for tax reporting purposes, as well as other relevant factors. We may establish a valuation allowance to reduce deferred tax assets to the amount we believe is more likely than not to be realized. Due to inherent complexities arising from the nature of our businesses, future changes in income tax law, tax sharing agreements or variances between our actual and anticipated operating results, we make certain judgments and estimates. Therefore, actual income taxes could materially vary from these estimates.

For the period January 1, 2005 through the date of our separation from IAC/InterActiveCorp ( IAC ) on August 9, 2005 (the Spin-Off ), we were a member of the IAC consolidated tax group. Accordingly, IAC filed a federal income tax return and certain state income tax returns on a combined basis with us for that period. IAC paid the entire combined income tax liability related to these filings. As such, our estimated income tax liability for that period was transferred to IAC upon Spin-Off. Under the terms of the Tax Sharing Agreement, IAC could make certain elections in preparation of these tax returns, which changed the amount of income taxes owed for the period before the Spin-Off. We recorded those changes as adjustments to stockholders' equity in accordance with Emerging Issues Task Force No. 94-10, *Accounting by a Company for the Income Tax Effects of Transactions Among or With its Shareholders under FASB Statement 109*.

On January 1, 2007, we adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 gives guidance related to the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and requires that we recognize in our financial statements the impact of a tax position, if that position is more likely than not to be sustained upon an examination, based on the technical merits of the position. As a result of the adoption of FIN 48, we recognized an approximately \$18.9 million increase in the liability for uncertain tax positions, of which \$14.7 million of the increase was accounted for as an increase to the January 1, 2007 balance of goodwill as the underlying tax positions related to business combinations and \$4.2 million as a reduction to the January 1, 2007 balance of retained earnings. These amounts do not include the federal tax benefits associated with these positions, which are immaterial.

As of January 1, 2007, we had \$65.5 million of liabilities for uncertain tax positions, \$14.0 million of which, if recognized, would decrease our provision for income taxes. We recognize interest and penalties related to our liabilities for uncertain tax positions in income tax expense. As of January 1, 2007 and September 30, 2007, we had approximately \$5.4 million and \$10.6 million accrued for the potential payment of estimated interest and penalties. For the nine months ended September 30, 2007, we recognized \$3.3 million of interest and penalties, net of federal benefit related to our liabilities for uncertain tax positions.



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

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. We are no longer subject to tax examinations by tax authorities for years prior to 1998.

***Certain Risks and Concentrations***

Our business is subject to certain risks and concentrations including dependence on relationships with travel suppliers, primarily airlines and hotels, dependence on third-party technology providers, exposure to risks associated with online commerce security and credit card fraud. In particular, we rely on our overall relationships with the major airlines. We also rely on global distribution system partners and third-party service providers for certain fulfillment services, including one third-party service provider for which we accounted for approximately 47% of its total revenue for the year ended December 31, 2006 and approximately 39% of its total revenue for the six months ended June 30, 2007.

***New Accounting Pronouncements***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 applies when another standard requires or permits assets or liabilities to be measured at fair value. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS 157 is effective in fiscal years beginning after November 15, 2007. We are in the process of determining the impact, if any, of this statement on our results from operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS Statement No. 115* ( SFAS 159 ), which is effective for fiscal years beginning after November 15, 2007. SFAS 159 permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We are in the process of determining the impact, if any, of this statement on our results from operations, financial position or cash flows.

**Note 3 Intangibles, net**

Our indefinite lived intangible assets relate principally to trade names and trademarks acquired in various acquisitions. As of September 30, 2006, we determined that our indefinite lived trade name intangible asset related to Hotwire was impaired. Accordingly, during the three months ended September 30, 2006, we performed a valuation of that asset, determined that its carrying amount exceeded its fair value and recognized an impairment charge of \$47.0 million. We based our measurement of fair value of the trade name intangible asset using the relief-from-royalty method. This method assumes that a trade name has value to the extent that its owner is relieved of the obligation to pay royalties for the benefits received therefrom.

**Note 4 Debt**

***Credit Facility***

In July 2005, we entered into a \$1.0 billion five-year unsecured revolving credit facility with a group of lenders, which is unconditionally guaranteed by certain Expedia subsidiaries and expires in August 2010. We had \$500.0 million outstanding under the revolving credit facility as of September 30, 2007. No amounts were outstanding under the facility as of December 31, 2006. The facility bears interest based on market interest rates plus a spread, which is determined based on our financial leverage. The interest rate was 6.3125% as of September 30, 2007.

The amount of stand-by letters of credit issued under the facility reduces the amount available to us. As of September 30, 2007 and December 31, 2006, there was \$51.9 million and \$52.0 million of outstanding stand-by letters of credit issued under the facility.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)*****Long-term Debt***

In August 2006, we privately placed \$500.0 million of senior unsecured notes due 2018. In March 2007, we completed an offer to exchange these notes for registered notes having substantially the same financial terms and covenants as the original notes (the unregistered and registered notes collectively, the *Notes*). The Notes bear a fixed rate interest of 7.456% with interest payable semi-annually in February and August of each year. The amount of accrued interest related to the Notes was \$4.7 million and \$13.4 million as of September 30, 2007 and December 31, 2006. The Notes are repayable in whole or in part on August 15, 2013, at the option of the holders of such Notes, at 100% of the principal amount plus accrued interest. We may redeem the Notes in accordance with the terms of the agreement, in whole or in part, at any time at our option.

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 13 *Guarantor and Non-Guarantor Supplemental Financial Information*.

**Note 5 *Derivative Instruments***

The fair value of our derivative financial instruments generally represents the estimated amounts we would expect to receive or pay upon termination of the contracts as of the reporting date.

As a result of the Spin-Off, we assumed certain obligations of IAC related to IAC's Ask Jeeves Convertible Subordinated Notes (*Ask Jeeves Notes*). As of September 30, 2007 and December 31, 2006, the related derivative liability balance was \$14.8 million included in other current liabilities and \$15.9 million included in other long-term liabilities on our consolidated balance sheets. During the nine months ended September 30, 2007, certain of these notes were converted and we released approximately 0.3 million shares of our common stock from escrow with a fair value of \$6.6 million to satisfy the conversion requirements. During the three months ended September 30, 2007 and 2006, we recognized a net loss of \$1.3 million and \$0.6 million related to these Ask Jeeves Notes. During the nine months ended September 30, 2007 and 2006, we recognized a net loss of \$5.5 million and a net gain of \$11.5 million related to these Ask Jeeves Notes.

As of September 30, 2007, we estimate that we could be required to release from escrow up to 0.5 million shares of our common stock (or pay cash in equal value, in lieu of issuing such shares). The Ask Jeeves Notes are due June 1, 2008; upon maturity of these notes, our obligation to satisfy demands for conversion ceases.

We entered into cross-currency swaps to hedge against the change in value of certain intercompany loans denominated in currencies other than the lending subsidiaries' functional currency. These swaps have been designated as cash flow hedges and are re-measured at fair value each reporting period. As of September 30, 2007 and December 31, 2006, the related derivative liability balances were \$21.1 million and \$13.1 million and were included in other long-term liabilities on our consolidated balance sheets.

**Note 6 *Stockholders' Equity******Share Repurchases***

During the three months ended September 30, 2007, we completed a tender offer pursuant to which we acquired 25 million tendered shares of our common stock at a purchase price of \$29.00 per share, for a total cost of \$725.0 million plus fees and expenses relating to the tender offer. We borrowed \$500.0 million under our existing credit facility to fund a portion of the purchase price for the shares and used cash on-hand for the remainder of the purchase price and to pay related fees and expenses.

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

During the three months ended March 31, 2007, we completed a tender offer pursuant to which we acquired 30 million tendered shares of our common stock at a purchase price of \$22.00 per share, for a total cost of \$660.0 million plus fees and expenses relating to the tender offer. We funded the purchase price for the shares using cash-on hand.

***Stock-based Awards***

Stock-based compensation expense relates primarily to expense for stock options and restricted stock units ( RSUs ). Since February 2003, we have awarded RSUs as our primary form of employee stock-based compensation. Our stock-based awards generally vest over five years.

As of September 30, 2007, we had stock-based awards outstanding representing approximately 28.3 million shares of our common stock consisting of approximately 8.4 million RSUs and stock options to purchase approximately 19.9 million common shares with a weighted average exercise price of \$16.66 and weighted average remaining life of 2.6 years.

Annual employee RSU grants typically occur during the first quarter of each year. During the nine months ended September 30, 2007, we granted 3.6 million RSUs. Net of cancellations, expirations and forfeitures occurring during this period, RSUs increased 2.3 million.

For the three and nine months ended September 30, 2007, stock-based compensation expense was \$14.4 million and \$44.2 million, consisting of \$11.3 million and \$33.6 million in expense primarily related to RSUs and \$3.1 million and \$10.6 million in stock option expense.

In October 2007, our Chairman and Senior Executive exercised 9.5 million options for a net delivery of shares of 3.7 million. Following this exercise, 10.4 million options, with a weighted average exercise price of \$24.05 and a weighted average remaining life of 4.9 years, remained outstanding.

***Comprehensive Income***

Comprehensive income was \$110.2 million and \$66.0 million for the three months ended September 30, 2007 and 2006, and \$245.4 million and \$186.2 million for the nine months ended September 30, 2007 and 2006. The primary differences between net income as reported and comprehensive income were foreign currency translation adjustments and net gains (losses) on cross-currency hedge contracts.

**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:

|                                                                 | Three months ended<br>September 30,   |           | Nine months ended<br>September 30, |            |
|-----------------------------------------------------------------|---------------------------------------|-----------|------------------------------------|------------|
|                                                                 | 2007                                  | 2006      | 2007                               | 2006       |
|                                                                 | (in thousands, except per share data) |           |                                    |            |
| <b>Net income</b>                                               | \$ 99,595                             | \$ 58,977 | \$ 230,507                         | \$ 177,794 |
| <b>Net earnings per share available to common stockholders:</b> |                                       |           |                                    |            |
| Basic                                                           | \$ 0.34                               | \$ 0.18   | \$ 0.77                            | \$ 0.52    |
| Diluted                                                         | 0.32                                  | 0.17      | 0.72                               | 0.50       |
| <b>Weighted average number of shares outstanding:</b>           |                                       |           |                                    |            |
| Basic                                                           | 292,171                               | 330,359   | 300,959                            | 340,660    |
| Dilutive effect of:                                             |                                       |           |                                    |            |
| Options to purchase common stock                                | 9,264                                 | 6,351     | 8,825                              | 7,879      |
| Warrants to purchase common stock                               | 8,528                                 | 2,288     | 6,537                              | 3,548      |
| Other dilutive securities                                       | 2,793                                 | 2,139     | 2,527                              | 2,988      |
| Diluted                                                         | 312,756                               | 341,137   | 318,848                            | 355,075    |

We have a two class share structure. 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 Other, net**

The following table presents the components of other, net:

|                                                       | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|-------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                       | 2007                                | 2006     | 2007                               | 2006      |
|                                                       | (in thousands)                      |          |                                    |           |
| Unrealized gain (loss) on derivative instruments, net | \$ (1,394)                          | \$ (603) | \$ (5,938)                         | \$ 11,609 |
| Federal excise tax refunds                            |                                     |          | 12,058                             |           |
| Foreign exchange rate gains (losses), net             | (12,265)                            | 1,785    | (15,450)                           | 3,317     |
| Equity in income (loss) of unconsolidated affiliates  | (294)                               | 1,745    | (3,848)                            | 2,331     |
| Other                                                 | 59                                  | (1)      | (275)                              | (208)     |
| Total                                                 | \$ (13,894)                         | \$ 2,926 | \$ (13,453)                        | \$ 17,049 |

***Federal Excise Tax Refunds***

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During the second quarter of 2007, we recorded refunds based on notification from the Internal Revenue Service ( IRS ) totaling \$14.7 million related to Federal Excise Tax ( FET ) taxes remitted to the IRS but not collected from customers for airline ticket sales by one of our subsidiaries in the third quarter of 2001 through the third quarter of 2004, plus accrued interest thereon. We recorded \$2.6 million to revenue as that amount relates to taxes remitted on airline ticket sales

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

subsequent to our acquisition of the subsidiary. We recorded \$12.1 million to other, net for taxes remitted on airline ticket sales prior to the acquisition and total interest earned on all underlying tax remittances.

**Note 9 Acquisitions and Other Investments**

During the nine months ended September 30, 2007, we acquired all or part of four travel-related companies, one of which is accounted for under the equity method as our ownership interest is 50%. The purchase price of these and other acquisition related costs totaled \$85.7 million, all of which we paid in cash. For the three acquisitions, we recorded \$34.2 million in goodwill and \$17.6 million of intangible assets with definite lives. The results of operations of each of the acquired businesses have been included in our consolidated results from each transaction closing date forward. The effect of these acquisitions on consolidated net revenue and operating income during the three and nine months ended September 30, 2007 was not significant. Based on the annual financial performance of one of the acquired companies during each of 2007 and 2008, we are obligated to pay an additional purchase price ranging from \$0 to a maximum of approximately \$100 million in total. The potential maximum additional amount may be achieved based on the annual results of 2007 or 2008, or the two periods combined, with funding of amounts based on 2007 performance expected in the first half of 2008 and for 2008 performance expected in the first half of 2009.

We have also entered into a commitment to provide the equity method investee a \$10 million revolving operating line of credit and a credit facility for up to \$20 million. As of the end of 2008, any amounts due under the credit facility are convertible, at our option, into shares of the company at a premium to the then fair market value. No amounts were drawn against either facility as of September 30, 2007.

**Note 10 Commitments and Contingencies*****Lease Commitments***

We have contractual obligations in the form of operating leases for office space and related office equipment for which we record the related expense on a monthly basis. Certain leases contain periodic rent escalation adjustments and renewal options. Operating lease obligations expire at various dates with the latest maturity in 2018. In June 2007, we entered into a ten-year lease for approximately 348,000 square feet of office space located in Bellevue, Washington. We expect the term and cash payments related to this lease to begin in November 2008.

Our estimated future minimum rental payments under operating leases with noncancelable lease terms that expire after September 30, 2007 are \$7.0 million for the remainder of 2007, \$29.0 million for 2008, \$28.7 million for 2009, \$26.1 million for 2010, \$24.8 million for 2011 and \$116.7 million for 2012 and thereafter.

***Legal Proceedings***

In the ordinary course of business, we are a party to various lawsuits. In the opinion of management, we do 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 taxes 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 affect on our financial results.

*Litigation Relating to Hotel Occupancy Taxes.* Lawsuits have been filed by thirty-seven cities and counties involving hotel occupancy taxes. In addition, there have been five consumer lawsuits filed relating to taxes and fees. The municipality and consumer lawsuits are in various stages ranging from responding to the complaint to discovery. We continue to defend these lawsuits vigorously. To date, twelve of the municipality lawsuits have been dismissed. Most of these dismissals have been without prejudice and, generally, allow the municipality to seek administrative remedies prior to pursuing further litigation. One dismissal (Pitt County, North Carolina) was based on a finding that the defendants were not subject to the local hotel occupancy tax ordinance. 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

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

occupancy taxes in the amount of \$18.8 million and \$17.5 million at September 30, 2007 and December 31, 2006, respectively. Our reserve is based on our best estimates and the ultimate resolution of these issues may be greater or less than the liabilities recorded.

**Note 11 Related Party Transactions*****Commercial Agreements with IAC***

Since the Spin-Off, we have continued to work with some of IAC's businesses pursuant to a variety of commercial agreements. These commercial agreements generally include (i) distribution agreements, pursuant to which certain subsidiaries of IAC distribute their respective products and services via arrangements with Expedia, and vice versa, (ii) services agreements, pursuant to which certain subsidiaries of IAC provide Expedia with various services and vice versa and (iii) office space lease agreements. The distribution agreements typically involve the payment of fees, usually on a fixed amount-per-transaction, revenue share or commission basis, from the party seeking distribution of the product or service to the party that is providing the distribution. Net operating expenses related to these transactions were less than \$4 million during the nine months ended September 30, 2007.

**Note 12 Segment Information**

We have two reportable segments: North America and Europe. 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 for evaluating segment performance is Operating Income Before Amortization (defined below), which includes allocations of certain expenses, primarily cost of revenue and facilities, to the segments. We base the allocations primarily on transaction volumes and other usage metrics; this methodology is periodically evaluated and may change. We do not allocate certain shared expenses to reportable segments such as partner services, product development, accounting, human resources and legal. We include these expenses in Corporate and Other.

Our North America segment provides a full range of travel services to customers in the United States, Canada and Mexico. This segment operates through a variety of brands including Classic Vacations, Expedia.com, Hotels.com, Hotwire.com and TripAdvisor. Our Europe segment provides travel services primarily through localized Expedia websites in Austria, Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden and the United Kingdom, as well as localized versions of Hotels.com in various European countries.

Corporate and Other includes ECT, Expedia Asia Pacific and unallocated corporate functions and expenses. ECT provides travel products and services to corporate customers in North America and Europe. Expedia Asia Pacific provides online travel information and reservation services primarily through eLong in the People's Republic of China, localized Expedia websites in Australia, Japan and New Zealand, as well as localized versions of Hotels.com in various Asian countries. In addition, we record amortization of intangible assets and any related impairment, as well as stock-based compensation expense in Corporate and Other.

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

The following table presents our segment information for the three and nine months ended September 30, 2007 and 2006. As a significant portion of our property and equipment is not allocated to our operating segments, we do not report the assets or related depreciation expense as it would not be meaningful, nor do we regularly provide such information to our chief operating decision makers.

|                                      | Three months ended September 30, 2007 |            |              |            |
|--------------------------------------|---------------------------------------|------------|--------------|------------|
|                                      | Corporate and                         |            |              | Total      |
|                                      | North America                         | Europe     | Other        |            |
|                                      | (in thousands)                        |            |              |            |
| Revenue                              | \$ 534,453                            | \$ 182,899 | \$ 42,244    | \$ 759,596 |
| Operating Income Before Amortization | \$ 238,555                            | \$ 68,472  | \$ (94,225)  | \$ 212,802 |
| Amortization of intangible assets    |                                       |            | (18,613)     | (18,613)   |
| Stock-based compensation             |                                       |            | (14,417)     | (14,417)   |
| Operating income (loss)              | \$ 238,555                            | \$ 68,472  | \$ (127,255) | \$ 179,772 |

|                                                     | Three months ended September 30, 2006 |            |              |            |
|-----------------------------------------------------|---------------------------------------|------------|--------------|------------|
|                                                     | Corporate and                         |            |              | Total      |
|                                                     | North America                         | Europe     | Other        |            |
|                                                     | (in thousands)                        |            |              |            |
| Revenue                                             | \$ 450,294                            | \$ 133,780 | \$ 29,868    | \$ 613,942 |
| Operating Income Before Amortization                | \$ 203,932                            | \$ 47,895  | \$ (71,816)  | \$ 180,011 |
| Amortization of intangible assets                   |                                       |            | (26,569)     | (26,569)   |
| Stock-based compensation                            |                                       |            | (16,439)     | (16,439)   |
| Amortization of non-cash distribution and marketing | (711)                                 |            |              | (711)      |
| Impairment of intangible asset                      |                                       |            | (47,000)     | (47,000)   |
| Operating income (loss)                             | \$ 203,221                            | \$ 47,895  | \$ (161,824) | \$ 89,292  |

|  | Nine months ended September 30, 2007 |        |       |       |
|--|--------------------------------------|--------|-------|-------|
|  | Corporate and                        |        |       | Total |
|  | North America                        | Europe | Other |       |
|  | (in thousands)                       |        |       |       |

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|                                      |              |            |              |              |
|--------------------------------------|--------------|------------|--------------|--------------|
| Revenue                              | \$ 1,446,233 | \$ 438,326 | \$ 115,471   | \$ 2,000,030 |
| Operating Income Before Amortization | \$ 629,366   | \$ 137,097 | \$ (262,171) | \$ 504,292   |
| Amortization of intangible assets    |              |            | (59,312)     | (59,312)     |
| Stock-based compensation             |              |            | (44,249)     | (44,249)     |
| Operating income (loss)              | \$ 629,366   | \$ 137,097 | \$ (365,732) | \$ 400,731   |

Nine months ended September 30, 2006

|                                                     | North America | Europe     | Corporate and Other | Total        |
|-----------------------------------------------------|---------------|------------|---------------------|--------------|
|                                                     |               |            | (in thousands)      |              |
| Revenue                                             | \$ 1,288,144  | \$ 331,084 | \$ 87,070           | \$ 1,706,298 |
| Operating Income Before Amortization                | \$ 563,216    | \$ 103,065 | \$ (213,507)        | \$ 452,774   |
| Amortization of intangible assets                   |               |            | (86,860)            | (86,860)     |
| Stock-based compensation                            |               |            | (57,547)            | (57,547)     |
| Amortization of non-cash distribution and marketing | (9,578)       |            |                     | (9,578)      |
| Impairment of intangible asset                      |               |            | (47,000)            | (47,000)     |
| Operating income (loss)                             | \$ 553,638    | \$ 103,065 | \$ (404,914)        | \$ 251,789   |

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

We have revised certain 2006 revenue and expense allocations between our segments to reflect current allocations for certain points of sale. There was no impact on total consolidated revenue or operating income before amortization as a result of these changes.

**Definition of Operating Income Before Amortization ( OIBA )**

We provide OIBA as a supplemental measure to GAAP. We define OIBA as operating income plus: (1) amortization of non-cash distribution and marketing expense, (2) stock-based compensation expense, (3) amortization of intangible assets and goodwill and intangible asset impairment, if applicable and (4) certain one-time items, if applicable.

OIBA is the primary operating metric used by which management evaluates the performance of our business, on which internal budgets are based, and by which management is compensated. Management believes that investors should have access to the same set of tools that management uses to analyze our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for, or superior to, GAAP. We endeavor to compensate for the limitation of the non-GAAP measure presented by also providing the comparable GAAP measures, GAAP financial statements, and descriptions of the reconciling items and adjustments, to derive the non-GAAP measure. We present a reconciliation of this non-GAAP financial measure to GAAP below.

OIBA represents the combined operating results of Expedia, Inc.'s businesses, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of other non-cash expenses that may not be indicative of our core business operations. We believe this measure is useful to investors for the following reasons:

It corresponds more closely to the cash operating income generated from our core operations by excluding significant non-cash operating expenses, such as stock-based compensation; and

It provides greater insight into management decision making at Expedia, as OIBA is our primary internal metric for evaluating the performance of our business.

OIBA has certain limitations in that it does not take into account the impact of certain expenses to our consolidated statements of income, including stock-based compensation, non-cash payments to partners, acquisition-related accounting and certain one-time items, if applicable. Due to the high variability and difficulty in predicting certain items that affect net income, such as tax rates, stock price and interest rates, we are unable to provide a reconciliation to net income on a forward-looking basis without unreasonable efforts.

**Reconciliation of OIBA to Operating Income and Net Income**

The following table presents a reconciliation of OIBA to operating income and net income for the three and nine months ended September 30, 2007 and 2006:

|                                                     | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|-----------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                                     | 2007                                | 2006       | 2007                               | 2006       |
|                                                     | (in thousands)                      |            |                                    |            |
| OIBA                                                | \$ 212,802                          | \$ 180,011 | \$ 504,292                         | \$ 452,774 |
| Amortization of intangible assets                   | (18,613)                            | (26,569)   | (59,312)                           | (86,860)   |
| Impairment of intangible asset                      |                                     | (47,000)   |                                    | (47,000)   |
| Stock-based compensation                            | (14,417)                            | (16,439)   | (44,249)                           | (57,547)   |
| Amortization of non-cash distribution and marketing |                                     | (711)      |                                    | (9,578)    |
| Operating income                                    | 179,772                             | 89,292     | 400,731                            | 251,789    |
| Interest income (expense), net                      | (1,052)                             | 4,840      | (4,309)                            | 13,102     |

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|                                                                      |           |           |            |            |
|----------------------------------------------------------------------|-----------|-----------|------------|------------|
| Other, net                                                           | (13,894)  | 2,926     | (13,453)   | 17,049     |
| Provision for income taxes                                           | (65,542)  | (37,707)  | (153,230)  | (103,523)  |
| Minority interest in (income) loss of consolidated subsidiaries, net | 311       | (374)     | 768        | (623)      |
| Net income                                                           | \$ 99,595 | \$ 58,977 | \$ 230,507 | \$ 177,794 |

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

**NOTE 13 Guarantor and Non-Guarantor Supplemental Financial Information**

Condensed consolidating financial information of Expedia, Inc. (the Parent ), our subsidiaries that are guarantors of the Notes (the Guarantor Subsidiaries ), and our subsidiaries that are not guarantors of the Notes (the Non-Guarantor Subsidiaries ) is shown below. The Notes 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. In this financial information, the Parent and Guarantor Subsidiaries account for investments in their wholly-owned subsidiaries using the equity method.

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**Notes to Consolidated Financial Statements (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**Three Months Ended September 30, 2007**  
(in thousands)

|                                                                | <b>Parent</b>    | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|----------------------------------------------------------------|------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenue                                                        | \$               | \$ 698,833                        | \$ 164,897                            | \$ (104,134)        | \$ 759,596          |
| Cost of revenue                                                |                  | 128,794                           | 23,595                                | (1,336)             | 151,053             |
| Gross profit                                                   |                  | 570,039                           | 141,302                               | (102,798)           | 608,543             |
| Operating expenses:                                            |                  |                                   |                                       |                     |                     |
| Selling and marketing                                          |                  | 283,589                           | 98,587                                | (102,835)           | 279,341             |
| General and administrative                                     |                  | 63,089                            | 20,260                                | 16                  | 83,365              |
| Technology and content                                         |                  | 37,131                            | 10,300                                | 21                  | 47,452              |
| Amortization of intangible<br>assets                           |                  | 16,627                            | 1,986                                 |                     | 18,613              |
| Operating income                                               |                  | 169,603                           | 10,169                                |                     | 179,772             |
| Other income (expense):                                        |                  |                                   |                                       |                     |                     |
| Equity in pre-tax earnings of<br>consolidated subsidiaries     | 113,269          | 11,071                            |                                       | (124,340)           |                     |
| Other, net                                                     | (15,250)         | (3,611)                           | 3,915                                 |                     | (14,946)            |
| Total other income, net                                        | 98,019           | 7,460                             | 3,915                                 | (124,340)           | (14,946)            |
| Income before income taxes<br>and minority interest            | 98,019           | 177,063                           | 14,084                                | (124,340)           | 164,826             |
| Provision for income taxes                                     | 1,576            | (62,774)                          | (4,344)                               |                     | (65,542)            |
| Minority interest in loss of<br>consolidated subsidiaries, net |                  |                                   | 311                                   |                     | 311                 |
| <b>Net income</b>                                              | <b>\$ 99,595</b> | <b>\$ 114,289</b>                 | <b>\$ 10,051</b>                      | <b>\$ (124,340)</b> | <b>\$ 99,595</b>    |

**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**Three Months Ended September 30, 2006**  
(in thousands)

|                       | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|-----------------------|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenue               | \$            | \$ 573,816                        | \$ 114,450                            | \$ (74,324)         | \$ 613,942          |
| Cost of revenue       |               | 114,125                           | 19,815                                | (846)               | 133,094             |
| Gross profit          |               | 459,691                           | 94,635                                | (73,478)            | 480,848             |
| Operating expenses:   |               |                                   |                                       |                     |                     |
| Selling and marketing |               | 213,732                           | 74,647                                | (73,293)            | 215,086             |

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|                                                                  |                  |                  |                   |                    |
|------------------------------------------------------------------|------------------|------------------|-------------------|--------------------|
| General and administrative                                       | 53,206           | 13,135           | (185)             | 66,156             |
| Technology and content                                           | 28,118           | 7,916            |                   | 36,034             |
| Amortization of intangible assets                                | 24,862           | 1,707            |                   | 26,569             |
| Impairment of intangible asset                                   | 47,000           |                  |                   | 47,000             |
| Amortization of non-cash distribution and marketing              | 711              |                  |                   | 711                |
| Operating income (loss)                                          | 92,062           | (2,770)          |                   | 89,292             |
| Other income (expense):                                          |                  |                  |                   |                    |
| Equity in pre-tax earnings (losses) of consolidated subsidiaries | 62,678           | (437)            | (62,241)          |                    |
| Other, net                                                       | (5,460)          | 11,488           |                   | 7,766              |
| Total other income, net                                          | 57,218           | 11,051           | 1,738             | (62,241)           |
| Income (loss) before income taxes and minority interest          | 57,218           | 103,113          | (1,032)           | (62,241)           |
| Provision for income taxes                                       | 1,759            | (39,437)         | (29)              |                    |
| Minority interest in income of consolidated subsidiaries, net    |                  |                  | (374)             | (374)              |
| <b>Net income (loss)</b>                                         | <b>\$ 58,977</b> | <b>\$ 63,676</b> | <b>\$ (1,435)</b> | <b>\$ (62,241)</b> |
|                                                                  |                  |                  |                   | <b>\$ 58,977</b>   |

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**Notes to Consolidated Financial Statements (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**Nine Months Ended September 30, 2007**  
(in thousands)

|                                                             | <b>Parent</b>     | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|-------------------------------------------------------------|-------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenue                                                     | \$                | \$ 1,833,268                      | \$ 442,338                            | \$ (275,576)        | \$ 2,000,030        |
| Cost of revenue                                             |                   | 350,051                           | 69,736                                | (3,790)             | 415,997             |
| Gross profit                                                |                   | 1,483,217                         | 372,602                               | (271,786)           | 1,584,033           |
| Operating expenses:                                         |                   |                                   |                                       |                     |                     |
| Selling and marketing                                       |                   | 755,384                           | 274,078                               | (271,948)           | 757,514             |
| General and administrative                                  |                   | 179,754                           | 55,305                                | 202                 | 235,261             |
| Technology and content                                      |                   | 102,214                           | 29,041                                | (40)                | 131,215             |
| Amortization of intangible assets                           |                   | 53,582                            | 5,730                                 |                     | 59,312              |
| Operating income                                            |                   | 392,283                           | 8,448                                 |                     | 400,731             |
| Other income (expense):                                     |                   |                                   |                                       |                     |                     |
| Equity in pre-tax earnings of consolidated subsidiaries     | 269,397           | 10,081                            |                                       | (279,478)           |                     |
| Other, net                                                  | (41,226)          | 19,350                            | 4,105                                 | 9                   | (17,762)            |
| Total other income, net                                     | 228,171           | 29,431                            | 4,105                                 | (279,469)           | (17,762)            |
| Income before income taxes and minority interest            | 228,171           | 421,714                           | 12,553                                | (279,469)           | 382,969             |
| Provision for income taxes                                  | 2,336             | (149,940)                         | (5,626)                               |                     | (153,230)           |
| Minority interest in loss of consolidated subsidiaries, net |                   |                                   | 768                                   |                     | 768                 |
| <b>Net income</b>                                           | <b>\$ 230,507</b> | <b>\$ 271,774</b>                 | <b>\$ 7,695</b>                       | <b>\$ (279,469)</b> | <b>\$ 230,507</b>   |

**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**Nine Months Ended September 30, 2006**  
(in thousands)

|                            | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|----------------------------|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenue                    | \$            | \$ 1,587,359                      | \$ 323,290                            | \$ (204,351)        | \$ 1,706,298        |
| Cost of revenue            |               | 325,964                           | 57,929                                | (3,036)             | 380,857             |
| Gross profit               |               | 1,261,395                         | 265,361                               | (201,315)           | 1,325,441           |
| Operating expenses:        |               |                                   |                                       |                     |                     |
| Selling and marketing      |               | 616,342                           | 199,620                               | (201,184)           | 614,778             |
| General and administrative |               | 171,059                           | 39,642                                | (131)               | 210,570             |

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|                                                                         |                   |                   |               |                     |                   |
|-------------------------------------------------------------------------|-------------------|-------------------|---------------|---------------------|-------------------|
| Technology and content                                                  |                   | 81,824            | 23,042        |                     | 104,866           |
| Amortization of intangible assets                                       |                   | 81,375            | 5,485         |                     | 86,860            |
| Impairment of intangible asset                                          |                   | 47,000            |               |                     | 47,000            |
| Amortization of non-cash<br>distribution and marketing                  |                   | 9,578             |               |                     | 9,578             |
| Operating income (loss)                                                 |                   | 254,217           | (2,428)       |                     | 251,789           |
| Other income (expense):                                                 |                   |                   |               |                     |                   |
| Equity in earnings of consolidated<br>subsidiaries                      | 170,797           | 1,739             |               | (172,536)           |                   |
| Other, net                                                              | 4,379             | 23,736            | 2,036         |                     | 30,151            |
| Total other income, net                                                 | 175,176           | 25,475            | 2,036         | (172,536)           | 30,151            |
| Income (loss) before income taxes<br>and minority interest              | 175,176           | 279,692           | (392)         | (172,536)           | 281,940           |
| Provision for income taxes                                              | 2,618             | (106,871)         | 730           |                     | (103,523)         |
| Minority interest in (income) loss<br>of consolidated subsidiaries, net |                   | (676)             | 53            |                     | (623)             |
| <b>Net income</b>                                                       | <b>\$ 177,794</b> | <b>\$ 172,145</b> | <b>\$ 391</b> | <b>\$ (172,536)</b> | <b>\$ 177,794</b> |

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**Notes to Consolidated Financial Statements (Continued)**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**September 30, 2007**  
(in thousands)

|                                                   |           | <b>Parent</b>    | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b>   | <b>Consolidated</b> |
|---------------------------------------------------|-----------|------------------|-----------------------------------|---------------------------------------|-----------------------|---------------------|
| <b>ASSETS</b>                                     |           |                  |                                   |                                       |                       |                     |
| Total current assets                              | \$        | 504,684          | \$ 1,453,027                      | \$ 352,657                            | \$ (991,648)          | \$ 1,318,720        |
| Investment in subsidiaries                        |           | 6,144,392        | 383,002                           |                                       | (6,527,394)           |                     |
| Intangible assets, net                            |           |                  | 942,260                           | 46,265                                |                       | 988,525             |
| Goodwill                                          |           |                  | 5,612,683                         | 300,251                               |                       | 5,912,934           |
| Other assets, net                                 |           | 6,419            | 152,639                           | 87,825                                | (4,936)               | 241,947             |
| <b>TOTAL ASSETS</b>                               | <b>\$</b> | <b>6,655,495</b> | <b>\$ 8,543,611</b>               | <b>\$ 786,998</b>                     | <b>\$ (7,523,978)</b> | <b>\$ 8,462,126</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>       |           |                  |                                   |                                       |                       |                     |
| Total current liabilities                         | \$        | 813,247          | \$ 1,939,868                      | \$ 329,371                            | \$ (991,648)          | \$ 2,090,838        |
| Long-term debt                                    |           | 500,000          |                                   |                                       |                       | 500,000             |
| Credit facility                                   |           | 500,000          |                                   |                                       |                       | 500,000             |
| Other liabilities and minority interest           |           |                  | 454,218                           | 79,758                                | (4,936)               | 529,040             |
| Stockholders' equity                              |           | 4,842,248        | 6,149,525                         | 377,869                               | (6,527,394)           | 4,842,248           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$</b> | <b>6,655,495</b> | <b>\$ 8,543,611</b>               | <b>\$ 786,998</b>                     | <b>\$ (7,523,978)</b> | <b>\$ 8,462,126</b> |

**CONDENSED CONSOLIDATING BALANCE SHEET**  
**December 31, 2006**  
(in thousands)

|                            |           | <b>Parent</b>    | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b>   | <b>Consolidated</b> |
|----------------------------|-----------|------------------|-----------------------------------|---------------------------------------|-----------------------|---------------------|
| <b>ASSETS</b>              |           |                  |                                   |                                       |                       |                     |
| Total current assets       | \$        | 461,397          | \$ 916,216                        | \$ 267,113                            | \$ (462,041)          | \$ 1,182,685        |
| Investment in subsidiaries |           | 5,951,961        | 295,989                           |                                       | (6,247,950)           |                     |
| Intangible assets, net     |           |                  | 989,668                           | 39,106                                |                       | 1,028,774           |
| Goodwill                   |           |                  | 5,593,031                         | 268,261                               |                       | 5,861,292           |
| Other assets, net          |           | 6,863            | 137,073                           | 58,412                                | (5,915)               | 196,433             |
| <b>TOTAL ASSETS</b>        | <b>\$</b> | <b>6,420,221</b> | <b>\$ 7,931,977</b>               | <b>\$ 632,892</b>                     | <b>\$ (6,715,906)</b> | <b>\$ 8,269,184</b> |

**LIABILITIES AND  
STOCKHOLDERS EQUITY**

|                                                   |           |                  |           |                  |                   |           |                    |           |                  |
|---------------------------------------------------|-----------|------------------|-----------|------------------|-------------------|-----------|--------------------|-----------|------------------|
| Total current liabilities                         | \$        |                  | \$        | 1,598,859        | \$ 263,306        | \$        | (462,040)          | \$        | 1,400,125        |
| Long-term debt                                    |           | 500,000          |           |                  |                   |           |                    |           | 500,000          |
| Other liabilities and minority interest           |           | 15,931           |           | 378,399          | 76,354            |           | (5,915)            |           | 464,769          |
| Stockholders' equity                              |           | 5,904,290        |           | 5,954,719        | 293,232           |           | (6,247,951)        |           | 5,904,290        |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$</b> | <b>6,420,221</b> | <b>\$</b> | <b>7,931,977</b> | <b>\$ 632,892</b> | <b>\$</b> | <b>(6,715,906)</b> | <b>\$</b> | <b>8,269,184</b> |

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**Notes to Consolidated Financial Statements (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**Nine months ended September 30, 2007**  
(in thousands)

|                                                              | Parent      | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidated |
|--------------------------------------------------------------|-------------|---------------------------|-----------------------------------|--------------|
| <b>Operating activities:</b>                                 |             |                           |                                   |              |
| Net cash provided by (used in) operating activities          | \$ (2,399)  | \$ 868,235                | \$ 99,520                         | \$ 965,356   |
| <b>Investing activities:</b>                                 |             |                           |                                   |              |
| Other, net                                                   | 2,399       | (88,499)                  | (60,819)                          | (146,919)    |
| Net cash provided by (used in) investing activities          | 2,399       | (88,499)                  | (60,819)                          | (146,919)    |
| <b>Financing activities:</b>                                 |             |                           |                                   |              |
| Borrowings on credit facility                                | 650,000     |                           |                                   | 650,000      |
| Repayments on credit facility                                | (150,000)   |                           |                                   | (150,000)    |
| Treasury stock activity                                      | (1,396,012) |                           |                                   | (1,396,012)  |
| Transfers (to) from related parties                          | 882,359     | (882,359)                 |                                   |              |
| Other, net                                                   | 13,653      | 10,228                    | 12,719                            | 36,600       |
| Net cash provided by (used in) financing activities          |             | (872,131)                 | 12,719                            | (859,412)    |
| Effect of exchange rate changes on cash and cash equivalents |             | 22,828                    | 1,404                             | 24,232       |
| <b>Net increase (decrease) in cash and cash equivalents</b>  |             | (69,567)                  | 52,824                            | (16,743)     |
| Cash and cash equivalents at beginning of period             |             | 658,540                   | 194,734                           | 853,274      |
| <b>Cash and cash equivalents at end of period</b>            | \$          | \$ 588,973                | \$ 247,558                        | \$ 836,531   |

**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**Nine Months Ended September 30, 2006**  
(in thousands)

|                                                     | Parent     | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidated |
|-----------------------------------------------------|------------|---------------------------|-----------------------------------|--------------|
| <b>Operating activities:</b>                        |            |                           |                                   |              |
| Net cash provided by (used in) operating activities | \$ (2,522) | \$ 690,668                | \$ 35,422                         | \$ 723,568   |
| <b>Investing activities:</b>                        |            |                           |                                   |              |

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|                                                                 |           |                   |                   |                   |
|-----------------------------------------------------------------|-----------|-------------------|-------------------|-------------------|
| Other, net                                                      | 2,522     | (91,860)          | (9,892)           | (99,230)          |
| Net cash provided by (used in) investing activities             | 2,522     | (91,860)          | (9,892)           | (99,230)          |
| <b>Financing activities:</b>                                    |           |                   |                   |                   |
| Repayment of short-term borrowings                              | (230,000) |                   | (649)             | (230,649)         |
| Proceeds from issuance of long-term debt, net of issuance costs | 495,682   |                   |                   | 495,682           |
| Treasury stock activity                                         | (295,105) |                   |                   | (295,105)         |
| Other, net                                                      | 29,423    | (11,501)          | 9,615             | 27,537            |
| Net cash provided by (used in) financing activities             |           | (11,501)          | 8,966             | (2,535)           |
| Effect of exchange rate changes on cash and cash equivalents    |           | 26,562            | (89)              | 26,473            |
| <b>Net increase in cash and cash equivalents</b>                |           | 613,869           | 34,407            | 648,276           |
| Cash and cash equivalents at beginning of period                |           | 151,523           | 145,893           | 297,416           |
| <b>Cash and cash equivalents at end of period</b>               | <b>\$</b> | <b>\$ 765,392</b> | <b>\$ 180,300</b> | <b>\$ 945,692</b> |

**Table of Contents****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, 2006, 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 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, 2006.

**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 and offline retail travel agents as well as 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.

Our portfolio of brands includes Expedia.com®, Hotels.com®, Hotwire.com™, our private label programs (Worldwide Travel Exchange and Interactive Affiliate Network), Classic Vacations, Expedia® Corporate Travel (ECT), eLong and TripAdvisor®. 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, 2006.

**Industry Trends**

The travel industry, including offline and online travel agencies, as well as suppliers of travel products and services, has been characterized by rapid and significant change.

The U.S. airline sector in particular is experiencing significant turmoil, with oil prices hitting all-time highs, the shift of capacity to low-cost carriers (LCCs) offering no frills flights at discounted prices and the entry and subsequent emergence of several of the largest traditional carriers from the protection of Chapter 11 bankruptcy proceedings.

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The traditional carriers need to rationalize high fixed cost structures to better compete in this environment has caused them to curtail their domestic capacities, increasing their load factors and enabling them to more easily pass along fare increases. Competitive pressures have also caused them to consider consolidation opportunities to better share fixed costs and reduce redundant flight routes. These attempts have generally been unsuccessful either due to antitrust concerns or reluctance among target companies to consummate mergers.

In addition, carriers have aggressively pursued cost reductions in every aspect of their operations, including distribution costs. Airlines have successfully pursued distribution cost reductions in a number of ways, including negotiating lower (or, in some cases, eliminating) travel agent commissions and overrides, increasing direct distribution through their proprietary websites, and reducing payments to global distribution system ( GDS ) intermediaries as contracts with the GDSs expired in mid to late 2006. These GDS reductions, in turn, impacted large travel agents, including Expedia, which have historically received a meaningful portion of their air remuneration from GDS providers.

In the last few years, the U.S. airline industry has enjoyed increasing load factors and rapidly escalating ticket prices. At the same time, the carriers which participate in the Expedia marketplace have been reducing their share of total air seat per mile capacity; while the LCCs, which have increased their relative capacity, have not generally participated in the Expedia marketplace. These trends have impacted our ability to obtain supply in our agency and merchant air businesses, reduced discounts for merchant air tickets and limited supply of merchant air tickets for use in our package travel offerings. As a result of these industry dynamics and reduced economics relating to recently negotiated GDS and airline agreements, our revenue per air ticket has declined significantly since the fourth quarter of 2004. However, as of September 30, 2007, we have successfully completed agreements with nine of the top ten domestic carriers, which we believe will result in more stabilized economics into 2008 as it relates to the non-booking fee portion of our air remuneration.

In the first half of 2007, U.S. carriers saw steady load factors and moderate airfare increases, which are generally positive developments for our business. In addition, we were successful in increasing our selection of content from LCCs, including AirTran Airways, Frontier Airlines, and JetBlue Airways. More recently, the carriers have had more success in passing along fare increases, and load factors have again been showing marked year-over-year growth. Traditional carriers have indicated a desire to keep capacities fairly flat through 2008.

The hotel sector has recently been characterized by robust demand and constrained supply, resulting in increasing occupancy rates and average daily rates ( ADRs ). More recently, hotels have begun to see a leveling in occupancies with ADRs continuing to grow. Industry experts expect demand growth to continue to outstrip supply through at least 2007. While increasing ADRs generally have a positive effect on our merchant hotel operations as our remuneration increases proportionally with the room price, higher ADRs can impact underlying demand, and the higher occupancies which accompany robust ADRs can restrict our ability to obtain merchant hotel room allocation, particularly in high occupancy destinations popular with our travel base, including our larger markets in Las Vegas, New York and Orlando. Higher occupancy levels also have historically tended to drive lower margins as hotel room suppliers have less need for third-party intermediaries to generate demand.

Increased usage and familiarity with the internet has driven rapid growth in online penetration of travel expenditures. According to PhoCusWright, an independent travel, tourism and hospitality research firm, in 2006 29% of worldwide leisure, unmanaged and corporate travel expenditures occurred online, with 49% in the United States, compared with 22% of European travel and 12% in the Asia Pacific region. These penetration rates have increased considerably 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.

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In addition to the growth of online travel agencies, airlines and lodging companies have aggressively pursued direct online distribution of their products and services over the last several years, with supplier growth outpacing online growth since 2002, and now accounting for nearly two-thirds of all online travel expenditures in the United States according to PhoCusWright. Going forward, airline supplier site growth is expected to move more in line with overall online air bookings growth, while hotel supplier sites are expected to continue growing faster than online hotel bookings growth.

Differentiation among the various travel websites has narrowed in the past several years, and the travel landscape has grown extremely competitive, with the need for competitors to generally differentiate their offerings on features other than price. This has also led to aggressive marketing spend by the travel suppliers and intermediaries.

### ***Business Strategy***

We play a fundamental role in facilitating travel, whether for leisure or business. We are committed to providing our travelers with the best set of resources to serve their travel needs by taking advantage of our critical assets — our brand portfolio, our technology and commitment to continuous innovation, our global reach and our breadth of product offering. In addition, we take advantage of our growing base of knowledge about our destinations, suppliers and travelers based on our unique position in the travel value chain.

A discussion of the critical assets that we leverage in achieving our business strategy follows:

*Portfolio of Travel Brands.* We seek to appeal to the broadest possible range of travelers and suppliers through our collection of industry-leading brands. We target several different demographics, from the value-conscious traveler through our Hotwire brand to luxury travelers seeking a high-touch, customized vacation package through our Classic Vacations brand. We believe our flagship Expedia brand appeals to the broadest range of travelers, with our extensive product offering ranging from single item bookings of discounted product to complex bundling of higher-end travel packages. Our Hotels.com site and its international versions target travelers with premium content about lodging properties, and generally appeal to travelers with shorter booking windows who prefer to drive to their destinations.

*Technology and Continuous Innovation.* Expedia has an established tradition of innovation, from Expedia.com's inception as a division of Microsoft, to our introduction of more recent innovations such as Hotwire's Airfare Savings Hub product, Hotels.com's slider tools for narrowing search results based on desired price, star and hotel ratings and TripAdvisor's traveler network and Facebook applications.

We intend to continue to aggressively innovate on behalf of our travelers and suppliers, including our current efforts to build a scaleable, service-oriented technology platform for our travelers, which will extend across our portfolio of brands. We expect this to result in improved flexibility and allow faster innovation. This transition should allow us to improve our site merchandising, browse and search functionality and add significant personalization features. This transition is occurring in a phased approach, with a small portion of our worldwide points of sale migrating to the new platform during 2007.

For our suppliers, we have developed proprietary technology that streamlines the interaction between some of our websites and hotel central reservation systems, making it easier for hotels to manage reservations made through our brands. We began offering more streamlined application programming interfaces for certain of our lodging partners in 2007 to enable faster and simpler integration of real-time hotel content and intend to continue investing in tools to make supplier integration easier, more seamless and cost effective.

*Global Reach.* Through the nine months ended September 30, 2007, international gross bookings and revenue accounted for approximately 30% of worldwide gross bookings and 31% of worldwide revenue. We currently operate over 70 branded points of sale in more than 50 countries across the globe, including Expedia-branded sites in the United States, Australia, Austria, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, New

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Zealand, Norway, Spain, Sweden and the United Kingdom. Our Hotels.com and TripAdvisor brands also maintain both U.S. points of sale and additional points of sale outside the United States. We also offer Chinese travelers an array of products and services through our majority ownership in eLong.

We intend to continue investing in and growing our existing international points of sale. We anticipate launching points of sale in additional countries where we find large travel markets and rapid growth of online commerce.

ECT currently conducts operations in the United States, Belgium, Canada, France, Germany, Italy, Spain and the United Kingdom. We believe the corporate travel sector represents a large opportunity for Expedia, and we believe we offer a compelling technology solution to businesses seeking to control travel costs and improve their employees travel experiences. We intend to continue investing in and expanding the geographic footprint of our ECT business.

In expanding our global reach, we are leveraging our significant investment in technology, operations, brand building, supplier integration and relationships and other areas since the launch of Expedia.com in 1996. We intend to continue leveraging this investment when launching points of sale in new countries, introducing website features, adding supplier products and services, and adding value-added content for travelers.

*Breadth of Product Offering.* We believe we offer a comprehensive array of innovative travel products and services to travelers. We plan to continue improving and growing these offerings, as well as expand them to our worldwide points of sale over time.

The majority of our revenue comes from transactions involving the booking of hotel reservations and the sale of airline tickets, either as stand-alone products or as part of package transactions. We are working to grow our package business as it results in higher revenue per transaction, and we also seek to continue diversifying our revenue mix beyond core air and hotel products to car rental, destination services, cruise and other product offerings. We are also working to increase the mix of revenue from advertising through expansion of our TripAdvisor model, as well as media enhancements across many of our other worldwide points of sale.

### ***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 of the year 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. As a result, revenue is 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 our 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 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.

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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 assumptions 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, 2006.

### ***Income Taxes***

In accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, we record income taxes under the liability method. Deferred tax assets and liabilities reflect our estimation of the future tax consequences of temporary differences between the carrying amounts of assets and liabilities for book and tax purposes. We determine deferred income taxes based on the differences in accounting methods and timing between financial statement and income tax reporting. Accordingly, we determine the deferred tax asset or liability for each temporary difference based on the enacted tax rates in effect for the years in which we expect to realize the underlying items of income and expense. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent earnings experience by jurisdiction, expectations of future taxable income, and the carryforward periods available to us for tax reporting purposes, as well as other relevant factors. We may establish a valuation allowance to reduce deferred tax assets to the amount we believe is more likely than not to be realized. Due to inherent complexities arising from the nature of our businesses, future changes in income tax law, tax sharing agreements or variances between our actual and anticipated operating results, we make certain judgments and estimates. Therefore, actual income taxes could materially vary from these estimates.

We record liabilities to address uncertain tax positions we have taken in previously filed tax returns or that we expect to take in a future tax return. The determination for required liabilities is based upon an analysis of each individual tax position, taking into consideration whether it is more likely than not that our tax positions, based on technical merits, will be sustained upon examination. For those positions for which we conclude it is more likely than not it will be sustained, we recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The difference between the amount recognized and the total tax position is recorded as a liability. The ultimate resolution of these tax positions may be greater or less than the liabilities recorded. We adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, in the first quarter of 2007. See Note 2 Summary of Significant Accounting Policies in the notes to the consolidated financial statements for further discussion.

### **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.

### **Segments**

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

Our North America segment provides a full range of travel services to customers in the United States, Canada and Mexico. This segment operates through a variety of brands including Classic Vacations, Expedia.com, Hotels.com, Hotwire.com and TripAdvisor.

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Our Europe segment provides travel services primarily through localized Expedia websites in Austria, Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden and the United Kingdom, as well as localized versions of Hotels.com in various European countries.

Corporate and Other includes ECT, Expedia Asia Pacific and unallocated corporate functions and expenses. ECT provides travel products and services to corporate customers in North America and Europe. Expedia Asia Pacific provides online travel information and reservation services primarily through eLong in the People's Republic of China, localized Expedia websites in Australia, Japan and New Zealand, as well as localized versions of Hotels.com in various Asian countries.

**Operating Metrics**

Our operating results are affected by certain metrics that represent the selling activities generated by our travel products and services. As travelers have increased their use of the internet to book their travel arrangements, we have seen our gross bookings increase, reflecting the growth in the online travel industry and our business acquisitions. 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.

***Gross Bookings and Revenue Margin***

|                              | Three months ended<br>September 30, |              |             | Nine months ended September<br>30, |               |             |
|------------------------------|-------------------------------------|--------------|-------------|------------------------------------|---------------|-------------|
|                              | 2007                                | 2006         | %<br>Change | 2007                               | 2006          | %<br>Change |
|                              | (\$ in thousands)                   |              |             | (\$ in thousands)                  |               |             |
| <b><i>Gross Bookings</i></b> |                                     |              |             |                                    |               |             |
| North America                | \$ 3,519,108                        | \$ 3,103,887 | 13%         | \$ 10,800,905                      | \$ 10,070,691 | 7%          |
| Europe                       | 1,162,614                           | 792,112      | 47%         | 3,229,503                          | 2,323,849     | 39%         |
| Corporate and Other          | 465,141                             | 364,956      | 27%         | 1,356,591                          | 1,079,386     | 26%         |
| Total gross bookings         | \$ 5,146,863                        | \$ 4,260,955 | 21%         | \$ 15,386,999                      | \$ 13,473,926 | 14%         |

***Revenue Margin***

|                      |       |       |       |       |
|----------------------|-------|-------|-------|-------|
| North America        | 15.2% | 14.5% | 13.4% | 12.8% |
| Europe               | 15.7% | 16.9% | 13.6% | 14.2% |
| Corporate and Other  | 9.1%  | 8.2%  | 8.5%  | 8.1%  |
| Total revenue margin | 14.8% | 14.4% | 13.0% | 12.7% |

Gross bookings increased \$885.9 million and \$1.9 billion, or 21% and 14%, for the three and nine months ended September 30, 2007 compared to the same periods in 2006. For the three and nine months ended September 30, 2007, North America gross bookings increased 13% and 7% compared to the same periods in 2006. For the three and nine months ended September 30, 2007, Europe gross bookings increased 47% and 39% compared to the same periods in 2006.

Revenue margin, which is defined as revenue as a percentage of gross bookings, increased 35 basis points and 33 basis points for the three and nine months ended September 30, 2007 compared to the same periods in 2006. For the three and nine months ended September 30, 2007, revenue margin increased 68 basis points and 60 basis points in our North America segment compared to the same periods in 2006. The increase in worldwide and North America revenue margin for the three and nine months ended September 30, 2007, as compared to the same periods in 2006, was primarily due to an increased mix of advertising and media and car rental revenue. The increase for the nine months ended September 30, 2007, as compared to the same period in 2006, was partially offset by the decline in revenue per air ticket. For the three and nine months ended September 30, 2007, revenue margin decreased 116 basis points and 67 basis points in our Europe segment compared to the same periods in 2006. Europe revenue margin

decreased in part due to lower revenue from more competitive hotel pricing and lower air booking fees.

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

|                     | Three months ended<br>September 30, |            |             | Nine months ended September<br>30, |              |             |
|---------------------|-------------------------------------|------------|-------------|------------------------------------|--------------|-------------|
|                     | 2007                                | 2006       | %<br>Change | 2007                               | 2006         | %<br>Change |
|                     | (\$ in thousands)                   |            |             | (\$ in thousands)                  |              |             |
| North America       | \$ 534,453                          | \$ 450,294 | 19%         | \$ 1,446,233                       | \$ 1,288,144 | 12%         |
| Europe              | 182,899                             | 133,780    | 37%         | 438,326                            | 331,084      | 32%         |
| Corporate and Other | 42,244                              | 29,868     | 41%         | 115,471                            | 87,070       | 33%         |
| Total revenue       | \$ 759,596                          | \$ 613,942 | 24%         | \$ 2,000,030                       | \$ 1,706,298 | 17%         |

Revenue increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to increases in worldwide merchant hotel revenue and advertising and media revenue, partially offset by a decline in our North America air revenue for the nine months ended September 30, 2007.

Worldwide merchant hotel revenue increased 22% and 18% for the three and nine months ended September 30, 2007, compared to the same periods in 2006. The increases were primarily due to a 16% and 11% increase in room nights stayed, including rooms delivered as a component of vacation packages as well as a 5% and 7% increase in revenue per room night. For the three and nine months ended September 30, 2007, revenue per room night increased due to a 5% and 6% increase in worldwide ADRs, partially offset by a slight decline in hotel raw margin during the three months ended September 30, 2007.

Worldwide air revenue increased 9% for the three months ended September 30, 2007 due to a 15% increase in air tickets sold, partially offset by a 5% decrease in revenue per air ticket. The decrease in revenue per air ticket primarily reflects reduced air service fees and, to a lesser extent, decreased compensation from air carriers and GDS providers. For the nine months ended September 30, 2007, worldwide air revenue decreased 6%, compared to the same period in 2006, due to a 15% decrease in revenue per air ticket partially offset by an increase of 11% in air tickets sold. The decrease in revenue per air ticket primarily reflects decreased compensation from air carriers and GDS providers.

Package revenue grew 12% and 4% for the three and nine months ended September 30, 2007 compared with the prior year periods primarily due to higher European package bookings. For the three months ended September 30, 2007, the increase was also due to increased revenue margin on North American package bookings.

The remaining worldwide revenue other than merchant hotel and air discussed above, which includes advertising and media, agency hotel, car rental, destination services, and cruise, increased by 40% and 37% for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to an increase in advertising and media revenue and car rental revenue.

**Cost of Revenue and Gross Profit**

|                 | Three months ended September 30, |            |             | Nine months ended September<br>30, |              |             |
|-----------------|----------------------------------|------------|-------------|------------------------------------|--------------|-------------|
|                 | 2007                             | 2006       | %<br>Change | 2007                               | 2006         | %<br>Change |
|                 | (\$ in thousands)                |            |             | (\$ in thousands)                  |              |             |
| Cost of revenue | \$ 151,053                       | \$ 133,094 | 13%         | \$ 415,997                         | \$ 380,857   | 9%          |
| % of revenue    | 19.9%                            | 21.7%      |             | 20.8%                              | 22.3%        |             |
| Gross profit    | \$ 608,543                       | \$ 480,848 | 27%         | \$ 1,584,033                       | \$ 1,325,441 | 20%         |
| % of revenue    | 80.1%                            | 78.3%      |             | 79.2%                              | 77.7%        |             |

Cost of revenue increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to higher costs associated with the increase in transaction volumes.

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Gross profit increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to increased revenue and an increase in gross margin. Gross margin increased 179 basis points and 152 basis points for these periods primarily due to the same factors contributing to our increased revenue margin, as well as cost savings from our various cost of revenue efficiency initiatives.

***Selling and Marketing***

|                       | Three months ended<br>September 30, |            |             | Nine months ended September<br>30, |            |             |
|-----------------------|-------------------------------------|------------|-------------|------------------------------------|------------|-------------|
|                       | 2007                                | 2006       | %<br>Change | 2007                               | 2006       | %<br>Change |
|                       | (\$ in thousands)                   |            |             | (\$ in thousands)                  |            |             |
| Selling and marketing | \$ 279,341                          | \$ 215,086 | 30%         | \$ 757,514                         | \$ 614,778 | 23%         |
| % of revenue          | 36.8%                               | 35.0%      |             | 37.9%                              | 36.0%      |             |

Selling and marketing expenses increased, compared to the same periods in 2006, primarily due to increased direct online and brand spend across our worldwide points of sale, as well as higher personnel costs.

We expect absolute amounts spent on selling and marketing to increase in 2007, and we expect selling and marketing to be higher as a percentage of revenue in 2007 as we aggressively support our established brands and geographies, grow our earlier stage international markets, increase our use of brand spend as markets reach scale, invest in our global advertising and media business and expand our corporate travel sales, destination services and market management teams.

***General and Administrative***

|                            | Three months ended<br>September 30, |           |             | Nine months ended September<br>30, |            |             |
|----------------------------|-------------------------------------|-----------|-------------|------------------------------------|------------|-------------|
|                            | 2007                                | 2006      | %<br>Change | 2007                               | 2006       | %<br>Change |
|                            | (\$ in thousands)                   |           |             | (\$ in thousands)                  |            |             |
| General and administrative | \$ 83,365                           | \$ 66,156 | 26%         | \$ 235,261                         | \$ 210,570 | 12%         |
| % of revenue               | 11.0%                               | 10.8%     |             | 11.8%                              | 12.3%      |             |

General and administrative expense increased, compared to the same periods in 2006, primarily due to higher personnel costs related to expansion of our corporate information technology functions, our European businesses and incentive compensation expense. We expect general and administrative expense to increase in absolute dollars but decrease as a percentage of revenue for the full year of 2007 versus 2006.

***Technology and Content***

|                        | Three months ended<br>September 30, |           |             | Nine months ended September<br>30, |            |             |
|------------------------|-------------------------------------|-----------|-------------|------------------------------------|------------|-------------|
|                        | 2007                                | 2006      | %<br>Change | 2007                               | 2006       | %<br>Change |
|                        | (\$ in thousands)                   |           |             | (\$ in thousands)                  |            |             |
| Technology and content | \$ 47,452                           | \$ 36,034 | 32%         | \$ 131,215                         | \$ 104,866 | 25%         |
| % of revenue           | 6.2%                                | 5.9%      |             | 6.6%                               | 6.1%       |             |

Technology and content expense increased in absolute costs and as a percentage of revenue primarily due to growth in personnel-related expenses in our software development and engineering teams as we increase our level of website innovation and increased amortization of capitalized software development costs, a significant amount of which was placed into service beginning in the fourth quarter of 2006 and continuing into 2007.

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Given our historical and ongoing investments in our enterprise data warehouse, new platform, geographic expansion, data centers, redundancy, call center technology, site merchandising, content management, site monitoring, networking, corporate travel, supplier integration and other initiatives, we expect technology and content expense to increase in absolute dollars and as a percentage of revenue for both 2007 and 2008.

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**Table of Contents****Amortization of Intangible Assets**

|                                   | Three months ended<br>September 30, |           |             | Nine months ended<br>September 30, |           |             |
|-----------------------------------|-------------------------------------|-----------|-------------|------------------------------------|-----------|-------------|
|                                   | 2007                                | 2006      | %<br>Change | 2007                               | 2006      | %<br>Change |
|                                   | (\$ in thousands)                   |           |             | (\$ in thousands)                  |           |             |
| Amortization of intangible assets | \$ 18,613                           | \$ 26,569 | (30%)       | \$ 59,312                          | \$ 86,860 | (32%)       |
| % of revenue                      | 2.5%                                | 4.3%      |             | 3.0%                               | 5.1%      |             |

Amortization of intangible assets decreased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, due primarily to the completion of amortization related to certain technology and supplier intangible assets over the past year, partially offset by amortization related to new business acquisitions.

**Impairment of Intangible Asset**

During the three months ended September 30, 2006, we recognized an impairment charge of \$47.0 million in relation to Hotwire's indefinite lived trade name intangible asset. There was no such charge in 2007.

**Amortization of Non-Cash Distribution and Marketing**

In 2006, we substantially utilized all media time we received from IAC in conjunction with the Spin-Off, with an original value of \$17.1 million.

**Operating Income**

|                  | Three months ended<br>September 30, |           |             | Nine months ended September<br>30, |            |             |
|------------------|-------------------------------------|-----------|-------------|------------------------------------|------------|-------------|
|                  | 2007                                | 2006      | %<br>Change | 2007                               | 2006       | %<br>Change |
|                  | (\$ in thousands)                   |           |             | (\$ in thousands)                  |            |             |
| Operating income | \$ 179,772                          | \$ 89,292 | 101%        | \$ 400,731                         | \$ 251,789 | 59%         |
| % of revenue     | 23.7%                               | 14.5%     |             | 20.0%                              | 14.8%      |             |

Operating income increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to an increase in gross profit, the intangible asset impairment in 2006 and a decrease in amortization of intangibles and amortization of non-cash distribution and marketing, offset primarily by growth in sales and marketing expense and technology and content expenses as a percentage of revenue.

**Operating Income Before Amortization ( OIBA )**

|              | Three months ended September<br>30, |            |             | Nine months ended September<br>30, |            |             |
|--------------|-------------------------------------|------------|-------------|------------------------------------|------------|-------------|
|              | 2007                                | 2006       | %<br>Change | 2007                               | 2006       | %<br>Change |
|              | (\$ in thousands)                   |            |             | (\$ in thousands)                  |            |             |
| OIBA         | \$ 212,802                          | \$ 180,011 | 18%         | \$ 504,292                         | \$ 452,774 | 11%         |
| % of revenue | 28.0%                               | 29.3%      |             | 25.2%                              | 26.5%      |             |

The increase in OIBA for the three and nine months ended September 30, 2007, compared to the same periods in 2006, was primarily due to an increase in gross profit, partially offset by growth in sales and marketing expenses and technology and content expenses as a percentage of revenue.

**Definition of OIBA**

We provide OIBA as a supplemental measure to GAAP. We define OIBA as operating income plus: (1) amortization of non-cash distribution and marketing expense, (2) stock-based compensation expense, (3) amortization of intangible assets and goodwill and intangible asset impairment, if applicable and (4) certain one-time items, if applicable.

OIBA is the primary operating metric used by which management evaluates the performance of our business, on which internal budgets are based, and by which management is compensated. Management believes that investors

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should have access to the same set of tools that management uses to analyze our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for, or superior to, GAAP. We endeavor to compensate for the limitation of the non-GAAP measure presented by also providing the comparable GAAP measures, GAAP financial statements, and descriptions of the reconciling items and adjustments, to derive the non-GAAP measure. We present a reconciliation of this non-GAAP financial measure to GAAP below.

OIBA represents the combined operating results of Expedia, Inc.'s businesses, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of other non-cash expenses that may not be indicative of our core business operations. We believe this measure is useful to investors for the following reasons:

It corresponds more closely to the cash operating income generated from our core operations by excluding significant non-cash operating expenses, such as stock-based compensation; and

It provides greater insight into management decision making at Expedia, as OIBA is our primary internal metric for evaluating the performance of our business.

OIBA has certain limitations in that it does not take into account the impact of certain expenses to our consolidated statements of income, including stock-based compensation, non-cash payments to partners, acquisition-related accounting and certain one-time items, if applicable. Due to the high variability and difficulty in predicting certain items that affect net income, such as tax rates, stock price and interest rates, we are unable to provide a reconciliation to net income on a forward-looking basis without unreasonable efforts.

***Reconciliation of OIBA to Operating Income and Net Income***

The following table presents a reconciliation of OIBA to operating income and net income for the three and nine months ended September 30, 2007 and 2006:

|                                                                      | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|----------------------------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                                                      | 2007                                | 2006       | 2007                               | 2006       |
|                                                                      | (in thousands)                      |            |                                    |            |
| OIBA                                                                 | \$ 212,802                          | \$ 180,011 | \$ 504,292                         | \$ 452,774 |
| Amortization of intangible assets                                    | (18,613)                            | (26,569)   | (59,312)                           | (86,860)   |
| Impairment of intangible asset                                       |                                     | (47,000)   |                                    | (47,000)   |
| Stock-based compensation                                             | (14,417)                            | (16,439)   | (44,249)                           | (57,547)   |
| Amortization of non-cash distribution and marketing                  |                                     | (711)      |                                    | (9,578)    |
| Operating income                                                     | 179,772                             | 89,292     | 400,731                            | 251,789    |
| Interest income (expense), net                                       | (1,052)                             | 4,840      | (4,309)                            | 13,102     |
| Other, net                                                           | (13,894)                            | 2,926      | (13,453)                           | 17,049     |
| Provision for income taxes                                           | (65,542)                            | (37,707)   | (153,230)                          | (103,523)  |
| Minority interest in (income) loss of consolidated subsidiaries, net | 311                                 | (374)      | 768                                | (623)      |
| Net income                                                           | \$ 99,595                           | \$ 58,977  | \$ 230,507                         | \$ 177,794 |

***Interest Income and Expense***

Three months ended  
September 30,

Nine months ended  
September 30,

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|                  | 2007              | 2006     | %<br>Change | 2007              | 2006      | %<br>Change |
|------------------|-------------------|----------|-------------|-------------------|-----------|-------------|
|                  | (\$ in thousands) |          |             | (\$ in thousands) |           |             |
| Interest income  | \$ 12,888         | \$ 9,697 | 33%         | \$ 30,709         | \$ 20,332 | 51%         |
| Interest expense | (13,940)          | (4,857)  | 187%        | (35,018)          | (7,230)   | 384%        |

Interest income increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to higher cash and cash equivalent balances.

Interest expense increased for the three and nine months ended September 30, 2007, compared to the same periods in 2006, primarily due to interest expense related to the \$500.0 million senior unsecured notes (the Notes )

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that we issued in August 2006. In addition, interest expense increased for the three months ended September 30, 2007 due to the \$500.0 million draw on our revolving credit facility in August 2007 to fund a portion of the tender offer completed in the third quarter of 2007. Interest expense will increase for 2007 versus 2006 due to interest expense related to the Notes and interest expense from August 2007 forward related to the draw on our credit facility.

**Other, Net**

|            | Three months ended<br>September 30, |          |          | Nine months ended<br>September 30, |           |          |
|------------|-------------------------------------|----------|----------|------------------------------------|-----------|----------|
|            | 2007                                | 2006     | % Change | 2007                               | 2006      | % Change |
|            | (\$ in thousands)                   |          |          | (\$ in thousands)                  |           |          |
| Other, net | \$ (13,894)                         | \$ 2,926 | (575%)   | \$ (13,453)                        | \$ 17,049 | (179%)   |

For the three months ended September 30, 2007, other, net primarily includes net losses of \$12.3 million from the fluctuation of exchange rates on foreign denominated assets and liabilities of U.S. dollar functional currency subsidiaries, net losses of \$1.4 million from fair value changes in and the settlement of derivative instruments related to the Ask Jeeves Notes and certain stock warrants and \$0.3 million of losses from unconsolidated equity affiliates. For the nine months ended September 30, 2007, other, net primarily includes net losses of \$15.5 million from the fluctuation of exchange rates on foreign denominated assets and liabilities of U.S. dollar functional currency subsidiaries, net losses of \$5.9 million from fair value changes in and the settlement of derivative instruments related to the Ask Jeeves Notes and certain stock warrants, as well as \$3.8 million of losses from unconsolidated equity affiliates, partially offset by a gain of \$12.1 million relating to federal excise tax refunds.

For the three and nine months ended September 30, 2006, other, net primarily includes net losses of \$0.6 million and net gains of \$11.6 million from fair value changes in and the settlement of derivative instruments related to the Ask Jeeves Notes and certain stock warrants as well as net gains of \$1.8 million and \$3.3 million from the fluctuation of exchange rates on foreign denominated assets and liabilities of U.S. dollar functional currency subsidiaries.

**Provision for Income Taxes**

|                            | Three months ended<br>September 30, |             |          | Nine months ended September<br>30, |              |          |
|----------------------------|-------------------------------------|-------------|----------|------------------------------------|--------------|----------|
|                            | 2007                                | 2006        | % Change | 2007                               | 2006         | % Change |
|                            | (\$ in thousands)                   |             |          | (\$ in thousands)                  |              |          |
| Provision for income taxes | \$ (65,542)                         | \$ (37,707) | 74%      | \$ (153,230)                       | \$ (103,523) | 48%      |
| Effective tax rate         | 39.8%                               | 38.8%       |          | 40.0%                              | 36.7%        |          |

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 39.8% and 40.0% for the three and nine months ended September 30, 2007, which is higher than the 35% statutory rate primarily due to state income taxes, non-deductible losses related to our derivative liabilities and interest accruals related to uncertain tax positions.

Our effective tax rate was 38.8% and 36.7% for the three and nine months ended September 30, 2006, which is higher than the 35% statutory rate primarily due to state income taxes and the valuation allowance on certain foreign losses, partially offset by non-taxable gains related to our derivative liabilities.

**Financial Position, Liquidity and Capital Resources**

Our principal sources of liquidity are cash flows generated from operations, our cash and cash equivalents balances, which were \$836.5 million and \$853.3 million as of September 30, 2007 and December 31, 2006, and our \$1.0 billion revolving credit facility, of which \$448.1 million was available to us as of September 30, 2007. This

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represents the total of the facility less \$500.0 million of outstanding borrowings and \$51.9 million of outstanding stand-by letters of credit. Outstanding credit facility borrowings bear interest based on our financial leverage; based on our September 30, 2007 financial statements, the interest rate would equate to a base rate plus 62.5 basis points. We may choose (1) the greater of the Prime rate or the Federal Funds Rate plus 50 basis points or (2) various durations of LIBOR as our base rate. The base rate is currently one-month LIBOR of 5.13%, and is due to re-price on November 15, 2007.

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 suppliers related to these bookings generally within two weeks after completing the transaction for air travel and, for all other merchant bookings, which is primarily our merchant hotel business, after the travelers' use and subsequent billing from the supplier. Therefore, there is generally a greater time from the receipt of cash from the traveler to the payment to the supplier, and this operating cycle represents a working capital source of cash to us. As long as the merchant hotel business continues to grow and our business model does not significantly change, we expect that changes in working capital will positively impact operating cash flows. If this business declines relative to our other businesses, or if there are changes to the model which compress the time between receipts of cash from travelers to payments to suppliers, our working capital benefits could be reduced, as was the case to a certain degree in fiscal 2006 as we increased the efficiency of our supplier payment process.

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. While we expect the impact of seasonal fluctuations to continue, merchant hotel growth rates or model changes as discussed above may affect working capital, which might counteract or intensify the anticipated seasonal fluctuations.

As of September 30, 2007, we had a deficit in our working capital of \$772.1 million compared to a deficit of \$217.4 million as of December 31, 2006. The increase in deficit is primarily a result of the completion of two tender offers during the nine months ended September 30, 2007, partially offset by the generation of working capital from operations.

We anticipate continued investment in the development and expansion of our operations. These investments include but are not limited to improvements to infrastructure, which include our enterprise data warehouse, servers, networking equipment and software, release improvements to our software code and continuing efforts to build a scalable, service-oriented technology platform that will extend across our portfolio of brands. A small portion of our worldwide points of sale are migrating, in a phased approach, to the new platform during 2007. Capital expenditures are expected to increase up to 10% in fiscal 2007. Our future capital requirements may include capital needs for acquisitions or expenditures in support of our business strategy. In the event we have acquisitions, this may reduce our cash balance and/or increase our debt. Legal risks and challenges to our business strategy may also negatively affect our cash balance.

Our cash flows are as follows:

|                                                                      | Nine months ended September 30, |            |            |
|----------------------------------------------------------------------|---------------------------------|------------|------------|
|                                                                      | 2007                            | 2006       | \$ Change  |
|                                                                      | (in thousands)                  |            |            |
| Cash provided by (used in):                                          |                                 |            |            |
| Operating activities                                                 | \$ 965,356                      | \$ 723,568 | \$ 241,788 |
| Investing activities                                                 | (146,919)                       | (99,230)   | (47,689)   |
| Financing activities                                                 | (859,412)                       | (2,535)    | (856,877)  |
| Effect of foreign exchange rate changes on cash and cash equivalents | 24,232                          | 26,473     | (2,241)    |

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For the nine months ended September 30, 2007, net cash provided by operating activities increased by \$241.8 million primarily due to an increase in changes in operating assets and liabilities, an increase in cash flows from operating income, partially offset by an increase in interest payments in the current period.

Cash used in investing activities increased by \$47.7 million for the nine months ended September 30, 2007 primarily due to a \$29.8 million increase in cash paid for acquisitions and a \$27.9 million increase in long-term investments and deposits mainly related to our 50% investment in a travel company.

Cash used in financing activities for the nine months ended September 30, 2007 primarily included cash paid to acquire shares in the first quarter and third quarter tender offers pursuant to which we acquired 30 million tendered shares of our common stock at a purchase price of \$22.00 per share and 25 million tendered shares of our common stock at \$29.00 per share, for a total cost of \$1.4 billion plus fees and expenses relating to the tender offers, partially offset by \$500 million in net borrowings on the revolving credit facility used to fund a portion of the third quarter tender offer and \$45.4 million in proceeds from stock option exercises. Cash used in financing activities for the nine months ended September 30, 2006 primarily included the \$230.6 million repayment of our revolving credit facility as well as \$295.1 million of treasury stock activity primarily related to share repurchases, partially offset by the net proceeds of \$495.7 million from our Notes issued in August 2006.

In October 2007, our Chairman and Senior Executive exercised options to purchase 9.5 million shares. 2.3 million shares were withheld by the Company to cover the exercise price of \$8.59 per share and 3.5 million shares were withheld to cover tax obligations, with a net delivery of 3.7 million shares. We cancelled all withheld shares and made the required tax payments of \$121 million in connection with the exercise. These tax payments will be classified as Financing activities on our consolidated statement of cash flows for the year ended December 31, 2007.

We reclassified certain foreign exchange effects on our cash balances from operating activities to effect of foreign exchange rate changes for the periods presented. The effect of foreign exchange on our cash balances denominated in foreign currency for the nine months ended September 30, 2007 showed a net decrease of \$2.2 million from the same period in 2006.

We currently have authorization, for which there is no fixed termination date, from our Board of Directors to repurchase up to 20 million outstanding shares of our common stock; no such repurchases have been made.

We also have a shelf registration statement filed with the SEC under which Expedia, Inc. may offer from time to time debt securities, guarantees of debt securities, preferred stock, common stock or warrants. The shelf registration statement expires on October 15, 2010.

In our opinion, available cash, funds from operations and available borrowings will provide sufficient capital resources to meet our foreseeable liquidity needs.

### ***Contractual Obligations and Commercial Commitments***

For a discussion of potential future commitments related to new acquisitions, see Note 9 Acquisitions and Other Investments in the notes to the consolidated financial statements. In addition, see Note 10 Commitments and Contingencies for updated future minimum lease commitments. There have been no other material changes outside the normal course of business to our contractual obligations and commercial commitments since December 31, 2006. Other than our contractual obligations and commercial commitments, including derivatives, we did not have any off-balance sheet arrangements as of September 30, 2007 or December 31, 2006.

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

There have been no material changes in our market risk during the nine months ended September 30, 2007, with the exception of interest rate risk as discussed below. 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, 2006.

***Interest Rate Risk***

In July 2005, we entered into a \$1.0 billion revolving credit facility. The revolving credit facility bears interest based on market interest rates plus a spread, which is determined based on our financial leverage. The interest rate was 6.3125% as of September 30, 2007. As a result, we will be susceptible to fluctuations in interest rates if we do not hedge the interest rate exposure arising from any borrowings under our revolving credit facility. As of September 30, 2007, our outstanding borrowing under the revolving credit facility was \$500.0 million. No borrowings were outstanding under the revolving credit facility as of December 31, 2006. A hypothetical 10% increase in market interest rates would not have a material effect on our results of operations.

We did not experience any significant impact from the changes in interest rates for the three months ended September 30, 2007.

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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 the design and operation 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, 2007 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, 2006 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007. The following are developments regarding such legal proceedings:

#### *Litigation Relating to Hotel Occupancy Tax*

*Expedia Washington.* A hearing on plaintiff's motion for class certification took place on September 28, 2007. The court has not yet ruled on plaintiff's motion.

*City of Los Angeles Litigation.* On July 26, 2007, the court signed an order staying the lawsuit until the cities have exhausted their administrative remedies.

*City of Fairview Heights, Illinois Litigation.* On July 12, 2006, the court granted in part and denied in part defendants' motion to dismiss. Certification discovery is ongoing.

*City of Findlay, Ohio Litigation.* On July 26, 2006, the court granted in part and denied in part defendants' motion to dismiss. Discovery is ongoing.

*City of Chicago, Illinois Litigation.* On September 27, 2007, the court issued an order denying defendants' motion to dismiss.

*City of Rome, Georgia Litigation.* On July 17, 2007, the Court of Appeals denied the City of Rome's motion to unseal the record. On September 12, 2007, plaintiff filed a motion in the City of Atlanta litigation, seeking to intervene in that litigation and asking the court to rescind the protective order agreed to by the parties and approved by the court.

*Pitt County, North Carolina Litigation.* A hearing on defendants' motion for reconsideration or certification of an interlocutory appeal was held on July 31, 2007. On August 13, 2007, the court granted defendants' motion for reconsideration, dismissing the lawsuit. The court found that the hotel occupancy tax ordinance at issue only applied to operators of hotels and because the defendants did not operate hotels, the tax only applied to the room price charged by the hotels themselves.

*Orange County, Florida Litigation.* On July 24, 2007, plaintiffs filed a motion for rehearing, or, in the alternative, for a final appealable judgment.

*City of Atlanta, Georgia Litigation.* On October 26, 2007, the Georgia Court of Appeals affirmed the trial court's order dismissing the City of Atlanta's lawsuit for failure to exhaust its administrative remedies. On November 5, 2007, the City of Atlanta filed a motion for reconsideration of the Court of Appeals decision.

*City of Charleston, South Carolina Litigation.* On November 5, 2007, the court denied the defendants' motion to dismiss.

*City of Gallup, New Mexico Litigation.* The defendants answered the complaint on August 27, 2007.

*Town of Mt. Pleasant, South Carolina Litigation.* On November 5, 2007, the court denied the defendants' motion to dismiss.

*Columbus, Georgia Litigation.* On October 5, 2007, the plaintiff filed a motion for declaratory judgment and injunctive relief in the Expedia lawsuit. On November 5, 2007, Expedia and Hotels.com removed the lawsuit to federal court.

*City of Orange, Texas Litigation.* On September 5, 2007, a federal magistrate issued a Report & Recommendation that the lawsuit be dismissed because the tax ordinance at issue imposes a tax on consideration paid to a hotel or motel, not on the amount that the guest pays to the defendants.

*City of Jacksonville, Florida Litigation.* On August 21, 2007, the court granted the defendants' motion to dismiss based on the plaintiff's failure to exhaust its administrative remedies.

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

*Cities of Columbus and Dayton, Ohio Litigation.* Defendants answered the amended complaint on August 31, 2007. Discovery is ongoing.

*North Myrtle Beach Litigation.* On September 30, 2007, the court denied defendants' motion to dismiss.

*Louisville/Jefferson County Metro Government, Kentucky Litigation.* The defendants answered the plaintiff's complaint on September 13, 2007.

*Nassau County, New York Litigation.* On August 17, 2007, the court granted defendants' motion dismissing the lawsuit due to the plaintiff's failure to exhaust its administrative remedies. On September 12, 2007, the plaintiff filed a notice of appeal.

*City of Fayetteville, Arkansas Litigation.* Plaintiff filed an amended complaint on July 24, 2007. On August 7, 2007, defendants filed a motion to dismiss. That motion is pending.

*City of Oakland, California Litigation.* On September 18, 2007, the defendants filed a motion to dismiss the lawsuit. On November 6, 2007, the court granted the defendant's motion to dismiss.

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

*Worldspan Litigation.* On September 4, 2007, the parties entered into a stipulation to stay the lawsuit until December 10, 2007.

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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, 2006, which could materially affect our business, financial condition or future results. The risks described 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 Repurchase***

On June 19, 2007, we announced our intention to repurchase up to 116,666,665 shares of our common stock in a tender offer at a price per share not less than \$27.50 and not greater than \$30.00. On July 25, 2007, we filed an amended tender offer pursuant to which we reduced our offer to repurchase to up to 25,000,000 shares of our common stock at a price per share not less than \$27.50 and not greater than \$30.00. During the three months ended September 30, 2007, we completed the tender offer pursuant to which we acquired 25,000,003 tendered shares of our common stock at a purchase price of \$29.00 per share, for a total cost of \$725 million plus fees and expenses relating to the tender offer. The 25,000,003 shares accepted for purchase included the 25,000,000 shares that we had offered to purchase plus three shares, as to which we exercised our right to purchase additional shares in accordance with applicable securities laws.

We currently have authorization, for which there is no fixed termination date, from our Board of Directors to repurchase up to 20,000,000 outstanding shares of our common stock; no such repurchases have been made.

A summary of the repurchase activity during the three months ended September 30, 2007 is as follows:

| Period               | Total Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid Per<br>Share | Total Number of<br>Shares<br>Purchased as Part<br>of<br>Publicly<br>Announced Plans<br>or Programs | Maximum Number<br>of<br>Shares that May Yet<br>Be<br>Purchased Under<br>the<br>Plans or Programs |
|----------------------|----------------------------------------|---------------------------------------|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| July 1-31, 2007      |                                        | \$                                    |                                                                                                    | 136,666,665(1)                                                                                   |
| August 1-31, 2007    | 25,000,003                             | 29.00                                 | 25,000,003                                                                                         | 20,000,000                                                                                       |
| September 1-30, 2007 |                                        |                                       |                                                                                                    | 20,000,000                                                                                       |
| Total                | 25,000,003                             |                                       | 25,000,003                                                                                         |                                                                                                  |

- (1) Includes (i) 20,000,000 shares subject to repurchase authorization announced on August 10, 2006 and (ii) 116,666,665 shares pursuant to our share repurchase announced on June 19, 2007, which was reduced to 25,000,000 shares on July 25, 2007.

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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.

| <b>Exhibit<br/>Number</b> | <b>Description</b>                                                                                                                                                                                  |
|---------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1                      | Separation Agreement between Paul Onnen and Expedia, Inc., dated August 30, 2007.                                                                                                                   |
| 31.1                      | Certification of the Chairman and Senior Executive pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2                      | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act       |
| 31.3                      | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act       |
| 32.1                      | Certification of the Chairman and Senior Executive pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act                                                  |
| 32.2                      | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act                                                        |
| 32.3                      | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act                                                        |

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**Signature**

Pursuant to the requirements of the Section 13 or 15(d) Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

November 7, 2007

Expedia, Inc.

By: /s/ MICHAEL B. ADLER

Michael B. Adler

Chief Financial Officer