TRAVELZOO INC
Form 10-Q
April 24, 2015

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

or

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

For the transition period from to .

Commission File No.: 000-50171

TRAVELZOO INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	36-4415727 (I.R.S. employer identification no.)
590 Madison Avenue, 37th Floor New York, New York (Address of principal executive offices)	10022 (Zip code)

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

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

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

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The number of shares of Travelzoo common stock outstanding as of April 24, 2015 was 14,730,454 shares.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$53,975	$54,812
Accounts receivable, less allowance for doubtful accounts of $304 and $436 as of March 31, 2015 and December 31, 2014, respectively	15,974	14,608
Income tax receivable	2,885	3,756
Deposits	598	74
Deferred tax assets	1,482	1,311
Prepaid expenses and other	2,530	2,802
Total current assets	77,444	77,363
Deposits	559	1,087
Deferred tax assets	1,482	1,460
Restricted cash	1,325	1,393
Property and equipment, net	8,693	9,022
Intangible assets, net	104	163
Total assets	$89,607	$90,488
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$22,526	$23,008
Accrued expenses and other	10,518	10,135
Deferred revenue	1,470	1,192
Income tax payable	689	574
Reserve for unexchanged promotional shares	—	1,393
Total current liabilities	35,203	36,302
Long-term tax liabilities	11,608	10,936
Long-term deferred rent and other	3,194	3,436
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value per share (5,000 shares authorized; none issued)	—	—
Common stock, $0.01 par value (40,000 shares authorized; 15,801 shares issued, 14,730 shares outstanding as of March 31, 2015 and December 31, 2014)	163	163
Treasury stock (at cost, 1,071 shares at March 31, 2015 and December 31, 2014)	(21,517)	(21,517)
Additional paid-in capital	11,191	11,043
Retained earnings	55,031	53,122
Accumulated other comprehensive loss	(5,266)	(2,997)
Total stockholders' equity	39,602	39,814
Total liabilities and stockholders' equity	$89,607	$90,488

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
Revenues	$36,492	$40,195
Cost of revenues	4,234	4,777
Gross profit	32,258	35,418
Operating expenses:		
Sales and marketing	17,996	17,843
General and administrative	10,460	10,578
Total operating expenses	28,456	28,421
Income from operations	3,802	6,997
Other income	(87)	122
Income before income taxes	3,715	7,119
Income taxes	1,806	2,481
Net income	$1,909	$4,638
Basic net income per share	$0.13	$0.31
Diluted net income per share	$0.13	$0.31
Shares used in computing basic net income per share	14,730	14,880
Shares used in computing diluted net income per share	14,730	14,970

See accompanying notes to unaudited condensed consolidated financial statements.

TRAVELZOO INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended March 31,	
	2015	2014
Net income	$1,909	$4,638
Other comprehensive income (loss):		
Foreign currency translation adjustment	(2,269)	(83)
Total comprehensive income (loss)	$(360)	$4,555

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended March 31, 2015	2014
Cash flows from operating activities:		
Net income	$1,909	$4,638
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	771	701
Provision for losses on accounts receivable	25	(52)
Stock-based compensation	148	395
Deferred income tax	(222)	76
Net foreign currency effect	111	(9)
Changes in operating assets and liabilities:		
Accounts receivable	(1,764)	(1,288)
Deposits	(37)	133
Income tax receivable	851	1,266
Prepaid expenses and other	281	447
Accounts payable	201	(2,984)
Reserve for unexchanged promotional shares	(1,393)	(1,226)
Accrued expenses	729	(1,179)
Income tax payable	144	722
Other non-current liabilities	672	111
Net cash provided by operating activities	2,426	1,751
Cash flows from investing activities:		
Purchases of property and equipment	(184)	(1,019)
Release of restricted cash	—	200
Net cash used in investing activities	(184)	(819)
Cash flows from financing activities:		
Repurchase of common stock	—	(5,569)
Reverse/forward stock split, including transaction costs	—	(479)
Net cash used in financing activities	—	(6,048)
Effect of exchange rate changes on cash and cash equivalents	(3,079)	(72)
Net decrease in cash and cash equivalents	(837)	(5,188)
Cash and cash equivalents at beginning of period	54,812	66,223
Cash and cash equivalents at end of period	$53,975	$61,035
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net	361	335
Leasehold improvements accrued	319	757

See accompanying notes to unaudited condensed consolidated financial statements.

TRAVELZOO INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: The Company and Basis of Presentation

Travelzoo Inc. (the “Company” or “Travelzoo”) is a global Internet media company. We inform over 27 million members in North America, Europe and Asia Pacific, as well as millions of website users, about the best travel, entertainment and local deals available from thousands of companies. Our deal experts source, research and test-book offers, recommending only those that meet Travelzoo’s rigorous quality standards. We provide travel, entertainment, and local businesses with a fast, flexible, and cost effective way to reach millions of consumers. Our revenues are generated primarily from advertising fees. In Asia Pacific, the Travelzoo business is operated by Travelzoo (Asia) Limited and Travelzoo Japan K.K. under a license agreement with Travelzoo Inc. and is not owned by the Company.

Our publications and products include the Travelzoo websites (www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the Travelzoo Top 20 e-mail newsletter, the Newsflash e-mail alert service, the SuperSearch pay-per-click travel search tool, and the Travelzoo Network, a network of third-party websites that list travel deals published by Travelzoo. Our Travelzoo websites include Local Deals and Getaways listings that allow our members to purchase vouchers for deals from local businesses such as spas, hotels and restaurants. We receive a percentage of the face value of the voucher from the local businesses. We also operate Fly.com, a travel search engine that allows users to quickly and easily find the best prices on flights from hundreds of airlines and online travel agencies.

Since November 1, 2009, the Travelzoo websites in Asia Pacific (cn.travelzoo.com, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, among others), the Travelzoo Top 20 e-mail newsletters in Asia Pacific and the Newsflash e-mail alert service in Asia Pacific have been published by Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly owned subsidiaries of Azzurro Capital Inc. ("Azzurro"), under a license agreement with the Company. There is a reciprocal revenue-sharing agreement among the entities operating the Travelzoo business in Asia Pacific and the Company related to cross-selling audiences.

Ralph Bartel, who founded Travelzoo and who is a Director of the Company is the sole beneficiary of the Ralph Bartel 2005 Trust, which is the controlling shareholder of Azzurro Capital Inc. As of March 31, 2015, Azzurro is the Company's largest stockholder, holding approximately 49.1% of the Company's outstanding shares. Azzurro currently holds a proxy given to it by Holger Bartel that provides it with a total of 50.4% of the voting power.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company and its results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and related notes as of and for the year ended December 31, 2014, included in the Company’s Form 10-K filed with the SEC on February 17, 2015.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated into U.S. dollars at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the period.

The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or any other future period, and the Company makes no representations related thereto.

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The Company was formed as a result of a combination and merger of entities founded by the Company's principal stockholder, Ralph Bartel. In 1998, Mr. Bartel founded Travelzoo.com Corporation, a Bahamas corporation, which issued 5,155,874 shares via the Internet to approximately 700,000 "Netsurfer stockholders" for no cash consideration, but subject to certain conditions as referred to below. In 1998, Mr. Bartel also founded Silicon Channels Corporation, a California corporation, to operate the Travelzoo website. During 2001, Travelzoo Inc. was formed as a subsidiary of Travelzoo.com Corporation, and Mr. Bartel contributed all of the outstanding shares of Silicon Channels Corporation to Travelzoo Inc. in exchange for 8,129,273 shares of Travelzoo Inc. and options to acquire an additional 2,158,349 shares at $1.00. Mr. Bartel exercised these options in January 2009.

In April 2002, Travelzoo.com Corporation was merged into Travelzoo Inc. Under and subject to the terms of the merger agreement, holders of promotional shares of Travelzoo.com Corporation ("Netsurfers") who established that they had satisfied certain prerequisite qualifications were allowed a period of 2 years following the effective date of the merger to receive one share of Travelzoo Inc. in exchange for each share of common stock of Travelzoo.com Corporation. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were also included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation; and therefore, no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. Thereafter, the Company began to offer a voluntary cash program for those who established that they had satisfied certain prerequisite qualifications for Netsurfer promotional shares as further described below. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect this reduction of the number of shares reported as outstanding. As of March 31, 2015, there were 14,730,454 shares of common stock outstanding.

On April 21, 2011, the Company entered into an agreement with the State of Delaware resolving all claims relating to an unclaimed property review which began in 2010. The primary issue raised in the preliminary findings from the review, received by the Company on April 12, 2011, concerned the shares of Travelzoo which have not been claimed by former Netsurfer stockholders of Travelzoo.com, which remained unexchanged in the 2002 merger, as discussed in the preceding paragraph. In the preliminary findings under the unclaimed property review, up to 3.0 million shares were identified as "demandable" under Delaware escheat laws. While the Company continues to take the position that such shares were a promotional incentive and were issuable only to persons who establish their eligibility as stockholders, the Company determined that it was in its best interest to promptly resolve all claims relating to the unclaimed property review. The Company made a $20.0 million cash payment to the State of Delaware on April 27, 2011 and received a complete release of those claims from the state of Delaware.

Since March 2012, the Company became subject to unclaimed property reviews by most of the other states in the United States. The auditing firm representing these states in the reviews has presented to the Company preliminary findings, which relate primarily to the promotional shares which remained unexchanged in the 2002 merger that were not covered by the settlement and release by the State of Delaware. During the three months ended March 31, 2012, the Company recorded a $3.0 million charge for the contingency related to the promotional shares which remained unexchanged in the 2002 merger.

In October 2013, the Company entered into settlement agreements with 35 additional states to resolve those states' claims related to similar unclaimed property audits. The multi-state settlement relates to approximately 700,000 additional shares of the Company that were not claimed by residents of those states following the merger, which those states claimed were subject to escheat. While the Company disputes the states' claims, the Company determined that it was in its best interest to resolve the disputes and settle with 35 of the states. The remaining states, which were not included in the multi-state settlement as of October 2013, had potential claims on approximately 400,000 additional shares that were not claimed by residents in those states following the merger.

During the year ended December 31, 2013, the Company recorded a $22.0 million charge related to settlements it entered into and for potential future settlements with the remaining states. During the year ended December 31, 2013, the Company made cash payments of $12.3 million to the settled states after completion of the required due diligence. During the year ended December 31, 2014, the Company settled with the remaining states and made cash payments of $3.7 million to the settled states after completion of the required due diligence. During the year ended December 31, 2014, the Company released $7.6 million of the reserve related to potential future settlements with the remaining states in connection with unexchanged promotional shares based upon the actual settlements with the remaining states under more favorable terms than previously estimated. As of December 31, 2014, the Company maintained estimated reserves related to the remaining settled states and made cash payments of $1.4 million to these settled states after completion of the required due diligence during the three months ended March 31, 2015.

Although the Company has settled the states unclaimed property claims with all states, the Company may still receive inquiries from certain potential Netsurfer promotional stockholders that had not provided their state of residence to the Company by April 25, 2004. Therefore, the Company is continuing its voluntary program under which it makes cash payments to individuals related to the promotional shares for individuals whose residence was unknown by the Company and who establish that they satisfy the original conditions required for them to receive shares of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. This voluntary program is not available for individuals whose promotional shares have been escheated to a state by the Company, except those individuals for which their residence was unknown to the Company. The accompanying consolidated financial statements include a charge for payments under this voluntary program in general and administrative expenses of $2,000 for the three months ended March 31, 2015.

The total cost of this voluntary program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company’s common stock price. The Company’s common stock price affects the potential liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. In order to receive payment under this voluntary program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation.

Note 2: Net Income Per Share

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

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

	Three Months Ended March 31,	
	2015	2014
Basic net income per share:		
Net income	$1,909	$4,638
Weighted average common shares	14,730	14,880
Basic net income per share	$0.13	$0.31
Diluted net income per share:		
Net income	$1,909	$4,638
Weighted average common shares	14,730	14,880
Effect of dilutive securities: stock options	—	90
Diluted weighted average common shares	14,730	14,970
Diluted net income per share	$0.13	$0.31

For the three months ended March 31, 2015 and March 31, 2014, options to purchase 425,000 and 175,000 shares of common stock, respectively, were not included in the computation of diluted net income per share because the effect would have been anti-dilutive.

Note 3: Financial Instruments

The following tables summarize our financial assets measured at fair value on a recurring basis at March 31, 2015 and December 31, 2014 (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance at March 31, 2015				
Cash	$53,975	$ 53,975	$—	$—
Total cash	$53,975	$ 53,975	$—	$—
Certificates of deposit	$675	$ —	$675	$—
Merchant bank deposit	650	650	—	—
Total restricted cash and cash equivalent	$1,325	$ 650	$675	$—
Balance at December 31, 2014				
Cash	$54,812	$ 54,812	$—	$—
Total cash	$54,812	$ 54,812	$—	$—
Certificates of deposit	$675	$ —	$675	$—
Merchant bank deposit	718	718	—	—
Total restricted cash and cash equivalent	$1,393	$ 718	$675	$—

At March 31, 2015, accounts receivable and accounts payable are not measured at fair value; however, the Company believes that the carrying amounts of these assets and liabilities are a reasonable estimate of their fair value because of their relative short maturity. Accounts receivable and accounts payable are categorized as Level 2.

There have been no transfers and no changes in valuation methods for these assets or liabilities for the periods ended March 31, 2015 and December 31, 2014.

Note 4: Intangible Assets

Intangible assets consist of the following (in thousands):

	March 31, 2015	December 31, 2014
Internet domain names and technology	$2,772	$2,772
Accumulated amortization	(2,668)	(2,609)
Total	$104	$163

Intangible assets have a useful life of 3 to 5 years. For the three months ended March 31, 2015 and 2014, amortization expense was $59,000 and $61,000, respectively.

Future expected amortization expense related to intangible assets at March 31, 2015 is as follows (in thousands):

Remainder of 2015	$104
Total	$104

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

Note 5: Commitments and Contingencies

On September 28, 2012, Metasearch Systems, LLC filed a lawsuit in the U.S. District Court for the District of Delaware against Travelzoo Inc. d/b/a Fly.com alleging infringement of several U.S. patents. Metasearch Systems alleges that the trip-planning metasearch service available on Fly.com infringes one or more claims of the asserted patents. During September 2012, Metasearch Systems filed similar lawsuits against several of Travelzoo's competitors including Expedia, Inc., Orbitz Worldwide, Inc., Travelocity.com, LP, Priceline.com, Inc., Yahoo! Inc., American Express Company, Kayak Software Corp., and BookIt.com. The action seeks unspecified damages and we are unable to estimate the possible loss or range of losses that could potentially result from the action. The Company believes that the action is without merit and intends to defend the suit vigorously.

On April 21, 2011, the Company entered into an agreement with the State of Delaware resolving all claims relating to an unclaimed property review which began in 2010. The primary issue raised in the preliminary findings from the review, received by the Company on April 12, 2011, concerned the promotional shares which remained unexchanged in the 2002 merger (unexchanged promotional shares) as discussed further in Note 1. In the preliminary findings under the unclaimed property review, up to 3.0 million shares were identified as "demandable" under Delaware escheat laws. While the Company continues to take the position that such shares were a promotional incentive and were issuable only to persons who established their eligibility as stockholders, the Company determined that it was in its best interest to promptly resolve all claims relating to the unclaimed property review. The Company made a $20.0 million cash payment to the State of Delaware on April, 2011 and received a complete release of those claims.

Since March 2012, the Company became subject to unclaimed property reviews by most of the other states in the U.S. that relate primarily to the unexchanged promotional shares, which were not covered by the settlement and release by the State of Delaware. During the three months ended March 31, 2012, the Company recorded a $3.0 million charge related to this unexchanged promotional shares contingency.

In October 2013, the Company entered into settlement agreements with 35 additional states to resolve those states' claims related to similar unclaimed property audits. The multi-state settlement relates to approximately 700,000 additional shares of the Company that were not claimed by residents of those states following the merger, which those states claim were subject to escheat. While the Company disputes the states' claims, the Company determined that it was in its best interest to resolve the disputes and settle with 35 of the states. The remaining states, which were not included in the multi-state settlement as of October 2013, had potential claims on approximately 400,000 additional shares that were not claimed by residents in those states following the merger.

During the year ended December 31, 2013, the Company recorded a $22.0 million charge related to settlements it entered into and for potential future settlements with the remaining states. During the year ended December 31, 2013, the Company made cash payments of $12.3 million to the settled states after completion of the required due diligence. During the year ended December 31, 2014, the Company settled with the remaining states and made cash payments of $3.7 million to the settled states after completion of the required due diligence. During the year ended December 31, 2014, the Company released $7.6 million of the reserve related to potential future settlements with the remaining states in connection with unexchanged promotional shares based upon the actual settlements with the remaining states under more favorable terms than previously estimated. As of December 31, 2014, the Company maintained estimated reserves related to the remaining settled states and made cash payments of $1.4 million to these settled states after completion of the required due diligence during the three months ending March 31, 2015.

Although the Company has settled the states unclaimed property claims with all states, the Company may still receive inquiries from certain potential Netsurfer promotional stockholders that had not provided their state of residence to the Company by April 25, 2004. Therefore, the Company is continuing its voluntary program under which it makes cash payments to individuals related to the promotional shares for individuals whose residence was unknown by the Company and who establish that they satisfy the original conditions required for them to receive shares of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. This voluntary program is not available for individuals whose promotional shares have been escheated to a state by the Company, except those individuals for which their residence was unknown to the Company. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of $2,000 for these cash payments for the three months ended March 31, 2015. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company’s common stock price. The Company’s common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. In order to receive payment under this voluntary program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation.

The Company leases office space in Canada, France, Germany, Spain, the U.K., and the U.S. under operating leases which expire between May 31, 2015 and November 30, 2024. We also have purchase commitments which represent the minimum obligations we have under agreements with certain of our vendors. These minimum obligations are less than our projected use for those periods. Payments may be more than the minimum obligations based on actual use.

The following table summarizes principal contractual commitments as of March 31, 2015 (in thousands):

	2015	2016	2017	2018	2019	Thereafter	Total
Operating leases	$3,730	$4,185	$3,667	$3,197	$2,862	$10,277	$27,918
Purchase Obligations	943	530	—	—	—	—	1,473
Total commitments	4,673	4,715	3,667	3,197	2,862	10,277	29,391

Local Deals and Getaways merchant payable included in accounts payable was $16.9 million and $18.1 million, as of March 31, 2015 and December 31, 2014, respectively.

Note 6: Income Taxes

In determining the quarterly provisions for income taxes, the Company uses an estimated annual effective tax rate, which is generally based on our expected annual income and statutory tax rates in the U.S., Canada and U.K. For the three months ended March 31, 2015, the Company’s effective tax rate was 48.6%. For the three months ended March 31, 2014, the Company’s effective tax rate was 34.9%. Our effective tax rate increased for the three months ended March 31, 2015 from the three months ended March 31, 2014, due primarily to a $565,000 income tax expense for unrecognized tax benefits related to certain state tax matters.

U.S. income and foreign withholding taxes have not been provided on undistributed earnings for certain non-U.S. subsidiaries. The undistributed earnings on a book basis for the non-U.S. subsidiaries as of March 31, 2015 are approximately $6.1 million. The Company intends to reinvest these earnings indefinitely in its operations outside the U.S. If the undistributed earnings are remitted to the U.S., these amounts would be taxable in the U.S. at the current federal and state tax rates net of foreign tax credits. Also, depending on the jurisdiction any distribution may be subject to withholding taxes at rates applicable for that jurisdiction. The estimated amount of the unrecognized deferred tax liability attributed to future dividend distributions of undistributed earnings is approximately $783,000 at March 31, 2015.

The Company maintains liabilities for uncertain tax positions. At March 31, 2015, the Company had approximately $10.0 million in total unrecognized tax benefits, consisting of unrecognized tax benefits of approximately $8.6 million which, if recognized, would favorably affect the Company’s effective income tax rate, and unrecognized tax benefits of approximately $1.4 million, which if recognized, would be recorded in discontinued operations.

The Company’s policy is to include interest and penalties related to unrecognized tax positions in income tax expense. To the extent accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction in the overall income tax provision in the period that such determination is made. As of March 31, 2015 and December 31, 2014, the Company had approximately $1.6 million and $1.5 million, respectively, in accrued interest and penalties related to uncertain tax positions. The Company is in various stages of multiple year examinations by federal taxing authorities. Although the timing of initiation, resolution and/or closure of audits is highly uncertain, it is reasonably possible that the balance of the gross unrecognized tax benefits related to the method of computing income taxes in certain jurisdictions and losses reported on certain income tax returns could significantly change in the next 12 months, including the $7.9 million unrecognized tax benefit related to the Company's 2011 settlement with the State of Delaware. These changes may occur through settlement with the taxing authorities or the expiration of the statute of limitations on the returns filed. The Company is unable to estimate the range of possible adjustments to the balance of the gross unrecognized tax benefits.

The Company files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is subject to U.S. federal and certain state tax examinations for years after 2009 and is subject to California tax examinations for years after 2005. The Company's 2009 and 2010 federal income returns are currently under examination, including a review of the impact of the sale of Asia Pacific business segment in 2009. These examinations may lead to ordinary course adjustments or proposed adjustments to our taxes or our net operating income. The Company has received a Revenue Agent’s Report (RAR) generally issued at the conclusion of an IRS examination, which was consistent with the Notice of Proposed Adjustment we received earlier from the IRS for the 2009 calendar year related to the sale of our Asia Pacific business segment with additional penalties. The RAR proposes an increase to the Company's U.S. taxable income which would result in additional federal tax, federal penalty and state tax expense totaling approximately $31 million, excluding interest and state penalties, if any. The proposed adjustment is primarily driven by IRS’s view that the Asia Pacific business segment assets sold by the Company had a significantly higher valuation than the sales proceeds the Company received upon the sale. The Company disagrees with the proposed adjustments and intends to vigorously contest them. The Company did not make any adjustments to its liabilities for uncertain tax positions related to the RAR during the three months ended March 31, 2015 because the Company does not believe the IRS’s valuation of Asia Pacific business segment assets is appropriate. If we are not able to resolve these proposed adjustments at the IRS examination level, we plan to pursue all available administrative and, if necessary, judicial remedies.

Note 7: Accumulated Other Comprehensive Loss

The following table summarizes the changes in accumulated balances of other comprehensive loss (in thousands):

	Three Months Ended March 31,	
	2015	2014
Beginning balance	$(2,997)	$(530)
Other comprehensive loss due to foreign currency transaction, net of tax	(2,269)	(83)
Ending balance	$(5,266)	$(613)

There were no amounts reclassified from accumulated other comprehensive income (loss) for the three months ended March 31, 2015 and 2014. Accumulated other comprehensive income (loss) consists of foreign currency translation gain or loss.

Note 8: Stock-Based Compensation and Stock Options

In November 2009, the Company granted an executive stock options to purchase 300,000 shares of common stock with an exercise price of $14.97, of which 75,000 options vest and become exercisable annually starting July 1, 2011. The options expire in November 2019. As of March 31, 2015, 300,000 of these options were outstanding and vested. As of March 31, 2015, there was no unrecognized stock-based compensation expense relating to these options. Total stock-based compensation for the three months ended March 31, 2015 and 2014 related to this option grant was nil and $187,000.

In January 2012, the Company granted certain executives stock options to purchase 100,000 shares of common stock with an exercise price of $28.98, of which 25,000 options become exercisable annually starting January 23, 2013. The options expire in January 2022. As of March 31, 2015, 50,000 options were outstanding and 37,500 of these options were vested. During 2014, 25,000 options were canceled and 25,000 options were forfeited upon the departure of an executive. Total stock-based compensation for the three months ended March 31, 2015 and 2014 related to the outstanding stock option grant were $60,000 and $74,000, respectively. As of March 31, 2015, there was approximately $189,000 of unrecognized stock-based compensation expense relating to these options. This amount is expected to be recognized over 0.8 years. The Company used a forfeiture rate of 0% as the Company does not have enough historical forfeiture data to estimate the forfeiture rate. To the extent the actual forfeiture rate is greater than what we have anticipated, stock-based compensation related to these options will be lower than our expectations.

In July 2013, the Company granted an executive stock options to purchase 75,000 shares of common stock with an exercise price of $29.58, of which 25,000 options become exercisable annually starting July 1, 2015. The options expire in July 2023. As of March 31, 2015, 75,000 options were outstanding and none of these options were vested. Total stock-based compensation for the three months ended March 31, 2015 and 2014 related to this option grant was $89,000 for each period. As of March 31, 2015, there was approximately $816,000 of unrecognized stock-based compensation expense relating to these options. This amount is expected to be recognized over 2.3 years. The Company used a forfeiture rate of 0% as the Company does not have enough historical forfeiture data to estimate the forfeiture rate. To the extent the actual forfeiture rate is greater than what we have anticipated, stock-based compensation related to these options will be lower than our expectations.

Note 9: Stock Repurchase Program

The Company's stock repurchase programs assist in offsetting the impact of dilution from employee equity compensation and for capital allocation purposes. Management is allowed discretion in the execution of the repurchase program based upon market conditions and consideration of capital allocation.

In July 2012, the Company announced a stock repurchase program authorizing the repurchase of up to 1,000,000 shares of the Company’s outstanding common stock. There were 29,000 shares remaining to be repurchased under this program as of December 31, 2013.

In January 2014, the Company announced a stock repurchase program authorizing the repurchase of up to 1,000,000 shares of the Company’s outstanding common stock. During the year ended December 31, 2014, the Company repurchased 261,000 shares of common stock for an aggregate purchase price of $5.9 million, which were recorded as part of treasury stock as of December 31, 2014. The Company did not repurchase any of its outstanding common stock during the three months ended March 31, 2015. There were 768,000 shares remaining to be repurchased under this program as of March 31, 2015.

Note 10: Reverse/Forward Stock Split

On June 11, 2013, a Special Committee of the Company’s Board of Directors, consisting of three independent directors, unanimously approved a reverse/forward stock split transaction (collectively referred to as the “reverse/forward split”), subject to shareholder approval. The reverse/forward split was intended to reduce the Company’s shareholder account administration costs by reducing the number of its shareholders.

On September 12, 2013, at the Company’s annual shareholders meeting, Travelzoo shareholders voted in favor of the reverse/forward split, with the transaction receiving the votes of both (A) a majority of the issued and outstanding shares of common stock and (B) a majority of the issued and outstanding shares of common stock that are not held or controlled, directly or indirectly, by directors or officers of the Company, including, without limitation, the shares held by Azzurro, our principal stockholder.

On November 6, 2013, the Special Committee approved the execution of the transaction after receiving an opinion from a financial advisor regarding the fairness of the transaction from a financial point of view to the Company's shareholders whose positions, individually considered, consisted of fewer than 25 shares, of the per-share consideration to be received by such shareholders in the reverse/forward split. The Special Committee received legal counsel from Young Conaway Stargatt & Taylor, LLP in connection with its review of the transaction. In addition, the Company received legal counsel from Skadden, Arps, Slate, Meagher & Flom LLP and Bryan Cave LLP in connection with the transaction.

On November 6, 2013, based upon the Special Committee’s approval of the transaction and the receipt of a fairness opinion from the financial advisor, the Company executed the shareholder approved reverse/forward split.

The reverse/forward split transaction consisted of a 1-for-25 reverse stock split of the Company's outstanding common stock, followed immediately by a 25-for-1 forward stock split. Shareholders who held less than 25 shares immediately prior to the reverse stock split received a right to cash payment based on and equal to their resulting fractional interest times the price of a share equal to the higher of (a) the trailing ten day average trading price of the Company’s common stock immediately preceding the consummation date of the reverse/forward split or (b) the average aggregate sales price received in the sale on the open market of the shares resulting from aggregation of the fractionalized interests. Shareholders that held 25 or more shares of common stock immediately before the reverse/forward split did not receive a right to cash payment; instead these shareholders continued to hold the same number of shares after completion of the reverse/forward split as they held immediately prior. A description of the terms and conditions of the reverse/forward split was set forth in the Company’s definitive Proxy Statement for the 2013 annual shareholders meeting filed with the SEC on July 25, 2013.

The reverse/forward split resulted in approximately 643,218 of the Company’s outstanding shares being fractionalized. Shareholders holding less than 25 shares of common stock immediately prior to the reverse split did not receive fractional shares in the reverse stock split; instead these shareholders had their shares converted into the right to receive a cash payment in exchange for and in proportion to the fractional share interests resulting from the reverse stock split. To fund the cash payment due to shareholders that held a right to receive cash from the transaction, the fractional share interests were aggregated by the Company’s transfer agent, who sold the aggregated shares in the open market following the execution of the transaction.

As of December 31, 2013, the Company completed the sales of the aggregated fractional shares from the reverse/forward split in the open market and the sales proceeds of $13.6 million were held by the Company’s transfer agent in anticipation of the payment to be made to the fractionalized shareholders and were included in Funds Held for Reverse/Forward Stock Split on the Company’s balance sheet. As of December 31, 2013, the total amount payable of $13.7 million to fractionalized shareholders as a result of the execution of the reverse/forward split was reflected as a Payable to Shareholders for Reverse/Forward Stock Split on the Company’s balance sheet.

For the year ended December 31, 2014, the Company’s retained earnings includes a total adjustment of $346,000 related to the reverse/forward split, which includes transaction costs. During the year ended December 31, 2014, the Company’s transfer agent issued checks amounting to $13.4 million to pay shareholders that held a right to cash in exchange for the fractional shares that were a result of the reverse/forward split. The Company's transfer agent intends to pay $191,000 due to the remaining shareholders that hold a right to cash after receiving the required documentation regarding their physical stock certificates. As of March 31, 2015, the sale proceeds of $191,000 are held by the

Company’s transfer agent in anticipation of the payment to be made to the fractionalized shareholders and are included in Prepaid Expense and Other on the Company’s balance sheet. As of March 31, 2015, the total amount payable of $191,000 to fractionalized shareholders as a result of the execution of the reverse/forward split is included in Accrued Expenses and Other on the Company’s balance sheet.

Note 11: Segment Reporting and Significant Customer Information

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

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

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

Three Months Ended March 31, 2015	North America	Europe	Elimination and Other	Consolidated
Revenues from unaffiliated customers	$24,713	$11,779	$—	$36,492
Intersegment revenues	257	38	(295)	—
Total net revenues	24,970	11,817	(295)	36,492
Operating income	$2,080	$1,722	$—	$3,802

Three Months Ended March 31, 2014	North America	Europe	Elimination and Other	Consolidated
Revenues from unaffiliated customers	$26,353	$13,842	$—	$40,195
Intersegment revenues	221	12	(233)	—
Total net revenues	26,574	13,854	(233)	40,195
Operating income	$4,604	$2,393	$—	$6,997

As of March 31, 2015	North America	Europe	Elimination	Consolidated
Long-lived assets	$7,536	$1,261	$—	$8,797
Total assets	$74,790	$38,593	$(23,776)	$89,607

As of December 31, 2014	North America	Europe	Elimination	Consolidated
Long-lived assets	$7,678	$1,507	$—	$9,185
Total assets	$73,508	$40,818	$(23,838)	$90,488

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

For the three months ended March 31, 2015 and 2014, the Company did not have any customers that accounted for 10% or more of revenue. As of March 31, 2015 and December 31, 2014, the Company had one customer that accounted for 13% and 11%, respectively, of accounts receivable.

The following table sets forth the breakdown of revenues (in thousands) by category and segment. Travel revenue includes travel publications (Top 20, Website, Newsflash, Travelzoo Network), Getaways vouchers and hotel booking. Search revenue includes SuperSearch and Fly.com. Local revenue includes Local Deals vouchers and entertainment offers (vouchers and direct bookings).

	Three Months Ended March 31,	
	2015	2014
North America		
Travel	$16,007	$17,229
Search	4,548	3,854
Local	4,158	5,270
Total North America revenues	$24,713	$26,353
Europe		
Travel	$9,737	$11,193
Search	559	979
Local	1,483	1,670
Total Europe revenues	$11,779	$13,842
Consolidated		
Travel	$25,744	$28,422
Search	5,107	4,833
Local	5,641	6,940
Total revenues	$36,492	$40,195

Revenue by geography is based on the billing address of the advertiser. Long-lived assets attributed to the U.S. and international geographies are based upon the country in which the asset is located or owned. The following table sets forth revenue for individual countries that exceed 10% of total revenue (in thousands):

	Three Months Ended March 31,	
	2015	2014
Revenue		
United States	$23,431	$24,740
United Kingdom	7,871	9,212
Rest of the world	5,190	6,243
Total revenues	$36,492	$40,195

The following table sets forth long lived asset by geographic area (in thousands):

	As of March 31, 2015	As of December 31,
United States	$7,107	$7,646
Rest of the world	1,690	1,539
Total long lived assets	$8,797	$9,185

Note 12: Related Party Transactions

Ralph Bartel, who founded Travelzoo and who is a Director of the Company is the sole beneficiary of the Ralph Bartel 2005 Trust, which is the controlling shareholder of Azzurro Capital Inc. As of March 31, 2015, Azzurro is the Company's largest stockholder, holding approximately 49.1% of the Company's outstanding shares. Azzurro currently holds a proxy given to it by Mr. Holger Bartel that provides it with a total of 50.4% of the voting power.

In 2009, the Company sold its Asia Pacific operating segment to Travelzoo (Asia) Limited and Travelzoo Japan K.K., subsidiaries of Azzurro Capital Inc. There is a reciprocal revenue-sharing and hosting agreement among the Azzurro entities operating the Travelzoo business in Asia Pacific and the Company related to cross-selling audiences and hosting and development services by the Company, which were entered into in connection with the sale of Asia Pacific business segment. The fees generated by the Company under these agreements amounted to $80,000 and $187,000 for the three months ended March 31, 2015 and 2014, respectively. The fees incurred by the Company under these agreements amounted to $7,000 and $28,000 for the three months ended March 31, 2014 and 2015, respectively. The Company presents the receivables and payables with the Azzurro entities operating the Travelzoo business in Asia Pacific under these agreements on a net basis on the balance sheet as they are subject to a net settlement agreement as of March 31, 2015. The Company's net receivable was $609,000 and $553,000 as of March 31, 2015 and December 31, 2014, respectively, and are included in prepaid expenses and other current assets in the accompanying unaudited condensed consolidated balance sheets. This net receivable is covered by a Guarantee Agreement between Travelzoo and Azzuro Capital, which provides assurance it will be collected in full. In addition, as part of the sale of the Asia Pacific operating segment in 2009, the Company obtained an option, which expires in June 2020, to repurchase the Asia Pacific business pursuant to the terms of the option agreement.

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

The information in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations, assumptions, estimates and projections about Travelzoo and our industry. These forward-looking statements are subject to the many risks and uncertainties that exist in our operations and business environment that may cause actual results, performance or achievements of Travelzoo to be different from those expected or anticipated in the forward-looking statements. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as “may”, “will”, “should”, “estimates”, “predicts”, “potential”, “continue”, “strategy”, “believes”, “anticipates”, “plans”, “expects”, “intends”, a expressions are intended to identify forward-looking statements. Travelzoo’s actual results and the timing of certain events could differ significantly from those anticipated in such forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed elsewhere in this report in the section entitled “Risk Factors” and the risks discussed in our other SEC filings. The forward-looking statements included in this report reflect the beliefs of our management on the date of this report. Travelzoo undertakes no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other circumstances occur in the future.

Overview

Travelzoo Inc. (the “Company”or “Travelzoo”) is a global Internet media company. We inform over 27 million members in North America, Europe and Asia Pacific, as well as millions of website users, about the best travel and entertainment deals available from thousands of companies. Our deal experts source, research and test-book offers, recommending only those that meet Travelzoo’s rigorous quality standards. We provide travel, entertainment and local businesses with a fast, flexible, and cost-effective way to reach millions of consumers. Our revenues are generated primarily from advertising fees. In Asia Pacific, the Travelzoo business is operated by Travelzoo (Asia) Limited and Travelzoo Japan K.K. under a License agreement with Travelzoo Inc. and is not owned by the Company.

Our publications and products include the Travelzoo websites (www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the Travelzoo Top 20 e-mail newsletter, and the Newsflash e-mail alert service. We operate SuperSearch, a pay-per-click travel search tool, and the Travelzoo Network, a network of third-party websites that list deals published by Travelzoo. Our Travelzoo websites include Local Deals and Getaways listings that allow our members to purchase vouchers for deals from local businesses such as spas, hotels and restaurants. We receive a percentage of the face value of the voucher from the local businesses. We also operate Fly.com, a travel search engine that allows users to quickly and easily find the best prices on flights from hundreds of airlines and online travel agencies.

On October 31, 2009, we sold our Asia Pacific operating segment to Azzurro Capital Inc. and its wholly-owned subsidiaries, Travelzoo (Asia) Limited and Travelzoo Japan K.K. We have not had significant ongoing involvement with the operations of the Asia Pacific operating segment and have not had material economic interests in the Asia Pacific operating segment since the completion of the sale. Starting November 1, 2009, the Travelzoo websites in Asia Pacific (cn.travelzoo.com, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, among others), the Travelzoo Top 20 e-mail newsletters in Asia Pacific and the Newsflash e-mail alert service in Asia Pacific have been published by Travelzoo (Asia) Limited and Travelzoo Japan K.K., under a license agreement with the Company. There is a reciprocal revenue-sharing agreement among the entities operating the Travelzoo business in Asia Pacific and the Company related to cross-selling audiences. In addition, as part of the sale of the Asia Pacific operating segment in 2009, the Company obtained an option, which expires in June 2020, to repurchase the Asia Pacific business pursuant to the terms of the option agreement.

More than 2,000 companies use our services, including Air New Zealand, Apple Vacations, British Airways, Expedia, Fairmont Hotels and Resorts, Hawaiian Airlines, Iceland Air, InterContinental Hotels Group, Interstate Hotels & Resorts, Key Tours International, Liberty Travel, Princess Cruises, Starwood Hotels & Resorts Worldwide, TripAdvisor, United Airlines, and Virgin America.

We have two operating segments based on geographic regions: North America and Europe. North America consists of our operations in Canada and the U.S. Europe consists of our operations in France, Germany, Spain, and the U.K. For the three months ended March 31, 2015, European operations were 32% of revenues. Financial information with respect to our business segments and certain financial information about geographic areas appears in Note 11 to the accompanying unaudited condensed consolidated financial statements.

When evaluating the financial condition and operating performance of the Company, management focuses on financial and non-financial indicators such as growth in the number of members to the Company's newsletters, operating margin, growth in revenues in the absolute and relative to the growth in reach of the Company's publications measured as revenue per member and revenue per employee as a measure of productivity.

How We Generate Revenues

Our revenues are advertising revenues, consisting primarily of listing fees paid by travel companies, entertainment companies and local businesses to advertise their offers on Travelzoo's media properties. Listing fees are based on audience reach, placement, number of listings, number of impressions, number of clicks, number of referrals, or percentage of the face value of vouchers sold. Insertion orders are typically for periods between one month and twelve months and are not automatically renewed. Merchant agreements for Local Deals and Getaways advertisers are typically for twelve months and are not automatically renewed. We have three separate groups of our advertising products: Travel, Search and Local.

Our Travel category of revenue includes the publishing revenue for negotiated high-quality deals from travel companies, such as hotels, airlines, cruises or car rentals and includes products such as Top 20, Website, Newsflash, Travelzoo Network, as well as Getaways vouchers and commission revenues from hotel booking reservations. The revenues generated from these products are based upon a fee for number of e-mails sent to our audience, a fee for clicks delivered to the advertisers, a fee for placement of the advertising on our website or a fee based on a percentage of the face value of vouchers sold or other items sold. We recognize revenue upon delivery of the e-mails, delivery of the clicks, over the period of placement of the advertising and upon the sale of the vouchers or other items sold. Commission revenues generated through provision of hotel booking reservations to hotels are recognized upon the estimated date the stay occurs at the hotel, which includes estimates of cancellations of the hotel bookings based upon historical patterns. If the hotel booking cannot be canceled then revenue is recognized upon booking.

Our Search category of revenue includes comparison shopping tools for consumers to quickly and easily compare airfares, hotel and car rental prices and includes SuperSearch and Fly.com products. The revenues generated from these products are based upon a fee for clicks delivered to the advertisers or a fee for clicks delivered to advertisers that resulted in revenue for advertisers (i.e., successful clicks). We recognize revenue upon delivery of the clicks or successful clicks.

Our Local category of revenue includes the publishing revenue for negotiated high-quality deals from local businesses, such as restaurants, spas, shows, and other activities and includes Local Deals vouchers and entertainment offers (vouchers and direct bookings). The revenues generated from these products are based upon a percentage of the face value of vouchers or items sold or a fee for clicks delivered to the advertisers. We recognize revenue upon the sale of the vouchers, when we receive notification of the direct bookings or upon delivery of the clicks. The Company earns a fee for acting as an agent in these transactions, which is recorded on a net basis and is included in revenue upon completion of the voucher sale. Certain merchant contracts in foreign locations allow us to retain fees related to vouchers sold that are not redeemed by purchasers upon expiration, which we recognize as revenue after the expiration of the redemption period and after there are no further obligations to provide funds to merchants, members or others.

Trends in Our Business

Our ability to generate revenues in the future depends on numerous factors such as our ability to sell more advertising to existing and new advertisers, our ability to increase our audience reach and advertising rates and our ability to develop and launch new products.

Our current revenue model primarily depends on advertising fees paid primarily by travel, entertainment and local businesses. A number of factors can influence whether current and new advertisers decide to advertise their offers with us. We have been impacted and expect to continue to be impacted by external factors such as the shift from offline to online advertising, the relative condition of the economy, competition and the introduction of new methods of advertising. The introduction of competing services and changing search algorithms by search engines such as Google, Yahoo! and Microsoft which may reduce the level or quality of Internet traffic to our services, in particular our Search products, SuperSearch and Fly.com, the competitive market pricing of voucher-based offerings may lead to us reducing our take rate (i.e., our commission) in order to maintain or grow the number of quality deals and merchants we are seeking. For example, the consolidation of the airline industry reduced our revenues generated from this sector, the reduction of capacity in the airline industry reduced demand to advertise for excess capacity, the introduction of new voucher-based products offered by competitors impacted our ability to sell our existing advertising products. A number of factors will have impact on our revenue, such as the reduction in spending by travel intermediaries due to their focus on improving profitability, the trend towards mobile usage by consumers, the willingness of consumers to purchase the deals we advertise, and the willingness of certain competitors to grow their business unprofitably. In addition, we have been impacted and expect to continue to be impacted by internal factors such as introduction of new advertising products, hiring and relying on key employees for the continued maintenance and growth of our business and ensuring our advertising products continue to attract the audience that advertisers desire. In response to declining Search product revenue, which includes SuperSearch and Fly.com products, the Company is reviewing the performance of these products, which may result in merging the products, discontinuing or replacing one or both of them. Challenges in traffic acquisition from search engines and poor monetization on mobile devices have led to declines in Search revenue. As we review these products and work on their improvement, revenue from our Search products may continue to decline.

Existing advertisers may shift from one advertising service (e.g. Top 20) to another (e.g. Local Deals and Getaways). These shifts between advertising services by advertisers could result in no incremental revenue or less revenue than in previous periods depending on the amount purchased by the advertisers, and in particular with Local Deals and Getaways, depending on how many vouchers are purchased by members. In addition, we are anticipating a shift from our existing hotel revenue to commission-based revenue as we expand the use of our hotel booking platform, which may result in lower revenue depending on volume of hotel bookings.

Local revenues have been and may continue to decline over time due to market conditions driven by competition and declines in consumer demand. Since the introduction of Local Deals in 2010 and Getaways in 2011, we have seen a decline in the number of vouchers sold and a decrease in the average take rate earned by us from the merchants for the voucher sold.

Our ability to continue to generate advertising revenue depends heavily upon our ability to maintain and grow an attractive audience for our publications. We monitor our members and page views of our websites to assess our efforts to maintain and grow our audience reach. We obtain additional members and activity on our websites by acquiring traffic from Internet search companies. The costs to grow our audience have had, and we expect to continue to have, a significant impact on our financial results and can vary from period to period. We may have to increase our expenditures on acquiring traffic to continue to grow or maintain our reach of our publications due to competition. We continue to see a shift in the audience accessing our services through mobile devices and social media. We are starting to address this growing channel of our audience through development of our mobile applications and through marketing on social media channels. However, we will have to keep pace with technological change and trend to further address this shift in the audience behavior in order to offset any related declines in revenue.

We believe that we can increase our advertising rates only if the reach of our publications increases. We do not know if we will be able to increase the reach of our publications. If we are able to increase the reach of our publications, we still may not be able to or want to increase rates given market conditions such as intense competition in our industry. We have not had any significant rate increase in recent years due to intense competition in our industry. Even if we increase our rates, the increased price may reduce the amount of advertisers willing to advertise with us and, therefore, decrease our revenue. We may need to decrease our rates based on competitive market conditions and the performance of our audience in order to maintain or grow our revenue.

We do not know what our cost of revenues as a percentage of revenues will be in future periods. Our cost of revenues will increase if the number of searches performed on Fly.com increases because we pay a fee based on the number of searches performed on Fly.com. Our cost of revenues will increase if the face value of vouchers that we sell for Local Deals and Getaways increases or the total number of vouchers sold increases because we have credit card fees based upon face value of vouchers sold, due to customer service costs related to vouchers sold and due to member refunds on vouchers sold. Our cost of revenues are expected to increase due to our effort to develop our hotel booking platform as well. We expect fluctuations in cost of revenues as a percentage of revenues from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations.

We do not know what our sales and marketing expenses as a percentage of revenue will be in future periods. Increased competition in our industry may require us to increase advertising for our brand and for our products. In order to increase the reach of our publications, we have to acquire a significant number of new members in every quarter and continue to promote our brand. One significant factor that impacts our advertising expenses is the average cost per acquisition of a new member. Increases in the average cost of acquiring new members may result in an increase of sales and marketing expenses as a percentage of revenue. We believe that the average cost per acquisition depends mainly on the advertising rates which we pay for media buys, our ability to manage our member acquisition efforts successfully, and the degree of competition in our industry. We may decide to accelerate our member acquisition for various strategic and tactical reasons and, as a result, increase our marketing expenses. We expect the average cost per acquisition to increase with our increased expectations for the quality of the members we acquire. We may see an unique opportunity for a brand marketing campaign that will result in an increase of marketing expenses. In addition, there may be a significant number of members that cancel or we may cancel their subscription for various reasons, which may drive us to spend more on member acquisition in order to replace the lost members. Further, we expect to continue our strategy over time to replicate our business model in selected foreign markets to result in a significant increase in our sales and marketing expenses and have a material adverse impact on our results of operations. Due to the continued desire to grow our business in both North America and Europe we expect relatively high level of sales and marketing expenses in the foreseeable future. We expect fluctuations in sales and marketing expenses as a percentage of revenue from year to year and from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations. We expect increased marketing expense to spur continued growth in members and revenue in future periods; however, we cannot be assured of this due to the many factors that impact our growth in members and revenue. We expect to adjust the level of such incremental spending during any given quarter based upon market conditions, as well as our performance in each quarter. We have increased and may continue to increase our spending on sales and marketing to increase the number of our members and address the growing audience from mobile and social media channels, as well as to increase our analytic capabilities to continuously improve the presentation of our offerings to our audience.

We do not know what our general and administrative expenses as a percentage of revenue will be in future periods. There may be fluctuations that have a material impact on our results of operations. We expect our headcount to continue to increase in the future. The Company’s headcount is one of the main drivers of general and administrative expenses. Therefore, we expect our absolute general and administrative expenses to continue to increase. We expect our continued expansion into foreign markets and development of new advertising formats to result in a significant additional increase in our general and administrative expenses. Our general and administrative expenses as a percentage of revenue may also fluctuate depending on the number of requests received related to a program under which the Company intends to make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, whose claims were not escheated to states and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. We expect an increase in professional fees for various initiatives. In addition, we expect to incur additional costs related to the development of our hotel booking platform capabilities, which we are developing, in part, to address the shift to mobile devices.

We do not know what our income taxes will be in future periods. There may be fluctuations that have a material impact on our results of operations. Our income taxes are dependent on numerous factors such as the geographic mix of our taxable income, federal and state and foreign country tax law and regulations and changes thereto, the determination of whether valuation allowances for certain tax assets are required or not, audits of prior years’ tax returns resulting in adjustments, resolution of uncertain tax positions and different treatment for certain items for tax versus books, such as the disposition of our Asia Pacific business segment in 2009 or our State of Delaware settlement during 2011. We expect fluctuations in our income taxes from year to year and from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations.

The key elements of our growth strategy include building a travel and lifestyle brand with a large, high-quality user base and offering our users products that keep pace with consumer preference and technology, such as the trend toward mobile usage by consumers. We expect to continue our efforts to grow; however, we may not grow or we may experience slower growth. Some examples of our efforts to expand our business internationally since our inception in the U.S. have been expansion to the U.K. in 2005, Canada in 2006, Germany in 2006, France in 2007 and Spain in 2008. We also have launched new products to grow our revenue, such as the introduction of Fly.com in 2009, Local Deals in 2010, Getaways in 2011, as well as our mobile application launches in 2011 and 2012. In late 2012, we bought an online hotel booking platform to assist in our development of a product to better serve hotels and to facilitate the development of our hotel booking platform. We have also increased our spending on addressing the shift of our audience to mobile devices and social media.

We believe that we can sell more advertising if the market for online advertising continues to grow and if we can maintain or increase our market share. We believe that the market for advertising continues to shift from offline to online. We do not know if we will be able to maintain or increase our market share. We do not know if we will be able to increase the number of our advertisers in the future. We do not know if we will have market acceptance of our new products or whether the market will continue to accept our existing products.

Results of Operations

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

	Three Months Ended March 31,			
	2015		2014	
Revenues	100.0	%	100.0	%
Cost of revenues	11.6		11.9	
Gross profit	88.4		88.1	
Operating expenses:				
Sales and marketing	49.3		44.4	
General and administrative	28.7		26.3	
Total operating expenses	78.0		70.7	
Income from operations	10.4		17.4	
Other income	(0.2	)	0.3	
Income before income taxes	10.2		17.7	
Income taxes	5.0		6.2	
Net income	5.2	%	11.5	%

Operating Metrics

The following table sets forth selected operating metrics in North America and Europe:

	Three Months Ended March 31,	
	2015	2014
North America		
Total members (1)	17,171,000	16,646,000
Average cost per acquisition of a new member	$2.29	$1.33
Revenue per member (3)	$5.87	$6.55
Revenue per employee (4)	$388,000	$375,000
Mobile application downloads	2,424,000	1,862,000
Social media followers	1,936,000	1,565,000
Europe		
Total members	7,458,000	6,912,000
Average cost per acquisition of a new member	$4.41	$2.73
Revenue per member (3)	$6.41	$8.69
Revenue per employee (4)	$304,000	$340,000
Mobile application downloads	1,265,000	982,000
Social media followers	525,000	436,000
Consolidated		
Total members (2)	24,550,000	23,558,000
Average cost per acquisition of a new member	$2.94	$1.89
Revenue per member (3)	$6.03	$7.16
Revenue per employee (4)	$356,000	$362,000
Mobile application downloads	3,689,000	2,844,000
Social media followers	2,461,000	2,001,000

(1) Members represent individuals who are signed up to receive one or more of our free email publications that present our travel, entertainment and local deals.

(2) In Asia Pacific, the Travelzoo business is operated by Travelzoo (Asia) Limited and Travelzoo Japan K.K. under a license agreement with Travelzoo Inc. The total member amounts exclude Asia Pacific members of 3,500,000 and 3,600,000, for the three months ended March 31, 2015 and 2014, respectively.

(3) Annualized revenue divided by number of members at the beginning of the year.

(4) Annualized revenue divided by number of employees at the end of the quarter.

Revenues

The following table sets forth the breakdown of revenues (in thousands) by category and segment. Travel revenue includes travel publications (Top 20, Website, Newsflash, Travelzoo Network), Getaways vouchers and hotel booking. Search revenue includes SuperSearch and Fly.com. Local revenue includes Local Deals vouchers and entertainment offers (vouchers and direct bookings).

	Three Months Ended March 31,	
	2015	2014
North America		
Travel	$16,007	$17,229
Search	4,548	3,854
Local	4,158	5,270
Total North America revenues	$24,713	$26,353
Europe		
Travel	$9,737	$11,193
Search	559	979
Local	1,483	1,670
Total Europe revenues	$11,779	$13,842
Consolidated		
Travel	$25,744	$28,422
Search	5,107	4,833
Local	5,641	6,940
Total revenues	$36,492	$40,195

North America

North America revenues decreased $1.6 million for the three months ended March 31, 2015 from the three months ended March 31, 2014. This decrease was due to the decrease in Local and Travel revenues offset by the increase in Search revenues. The decrease in Local revenues of $1.1 million was primarily due to the decreased number of Local Deals vouchers sold. The decrease in Travel revenue of $1.2 million was primarily due to the decreased number of Getaways vouchers sold and paid clicks. The increase in Search revenue of $694,000 was primarily due to the increased number of clicks that generate revenue as a result of increased spending on traffic acquisition.

Europe

Europe revenues decreased $2.1 million for the three months ended March 31, 2015 from the three months ended March 31, 2014. This decrease was primarily due to the decrease in Travel and Search revenues. The decrease in Travel revenue of $1.5 million was primarily due to the decreased number of Getaways vouchers sold. The decrease in Search revenue of $419,000 was primarily due to the decreased number of clicks that generate revenue as a result of decreased spending on traffic acquisition.

For the three months ended March 31, 2015 and 2014, none of our customers accounted for 10% or more of our revenue.

Foreign currency movements relative to the U.S. dollar negatively impacted our revenues from our operations in Europe by approximately $1.6 million for the three months ended March 31, 2015. Foreign currency movements relative to the U.S. dollar positively impacted our revenues from our operations in Europe by approximately $740,000 for the three months ended March 31, 2014.

Cost of Revenues

Cost of revenues consists primarily of network expenses, including fees we pay for co-location services and depreciation and maintenance of network equipment, payments made to third-party partners of the Travelzoo Network, fees we pay related to user searches on Fly.com, amortization of capitalized website development costs, credit card fees, certain estimated member refunds and customer service costs associated with vouchers we sell, and salary expenses associated with network operations and customer service staff. Cost of revenues was $4.2 million and $4.8 million for the three months ended March 31, 2015 and March 31, 2014, respectively.

Cost of revenue decreased $543,000 for the three months ended March 31, 2015 from the three months ended March 31, 2014, due primarily to a decrease of $394,000 in Local Deals and Getaways costs including a $171,000 decrease in member refunds, a $176,000 decrease in fees we paid related to user searches on Fly.com, offset by a $216,000 increase in payments made to third-party partners of the Travelzoo Network.

Operating Expenses

Sales and Marketing

Sales and marketing expenses consist primarily of advertising and promotional expenses, salary expenses associated with sales, marketing and production staff, expenses related to our participation in industry conferences, and public relations expenses. Sales and marketing expenses were $18.0 million and $17.8 million for the three months ended March 31, 2015 and 2014, respectively. For the three months ended March 31, 2015 and 2014, advertising expenses accounted for 38% and 32%, respectively, of total sales and marketing expenses and consisted primarily of online advertising referred to as traffic acquisition cost and member acquisition costs. The goal of our advertising was to acquire new members to our e-mail products, increase the traffic to our websites, increase brand awareness and increase our audience through mobile and social media channels.

Sales and marketing expenses increased $153,000 for the three months ended March 31, 2015 from the three months ended March 31, 2014. The increase was primarily due to a $1.9 million increase in member acquisition and marketing costs, offset by a $665,000 planned decrease in Search traffic acquisition costs, and a $659,000 decrease in salary and employee related expenses due in part to a decrease in headcount.

General and Administrative

General and administrative expenses consist primarily of compensation for administrative, executive, and software development staff, fees for professional services, rent, bad debt expense, amortization of intangible assets, and general office expense. General and administrative expenses were $10.5 million and $10.6 million for the three months ended March 31, 2015 and 2013, respectively.

General and administrative expenses decreased $118,000 for the three months ended March 31, 2015 from the three months ended March 31, 2014. The decrease was primarily due to a $602,000 decrease in salary and employee related expenses due in part to a decrease in headcount, a $221,000 decrease in rent, office and insurance expense, offset by a $763,000 increase in professional service expenses related to the development of our hotel booking platform capabilities.

Unexchanged Promotional Shares

On April 21, 2011, the Company entered into an agreement with the State of Delaware resolving all claims relating to a previously-announced unclaimed property review. The primary issue raised in the preliminary findings from the review, received by the Company on April 12, 2011, concerned the shares of Travelzoo which have not been claimed by former shareholders of Travelzoo.com Corporation following a 2002 merger, as previously disclosed in the Company’s report on Form 10-K. In the preliminary findings under the unclaimed property review, up to 3.0 million shares were identified as “demandable” under Delaware escheat laws. While the Company continues to take the position that such shares were a promotional incentive and were issuable only to persons who establish their eligibility as shareholders, the Company determined that it was in its best interest to promptly resolve all claims relating to the unclaimed property review. Under the terms of the agreement, the Company made a $20.0 million cash payment to the State of Delaware on April 27, 2011 and received a complete release of those claims. The $20.0 million payment was recorded as an expense in the three months ended March 31, 2011.

Since March 2012, the Company has become subject to unclaimed property reviews by most of the other states in the U.S. that relate primarily to the unexchanged promotional shares, which were not covered by the settlement and release by the State of Delaware. During the three months ended March 31, 2012, the Company recorded a $3.0 million charge related to this unexchanged promotional shares contingency.

In October 2013, the Company entered into agreements with 35 additional states to resolve those states' claims related to similar unclaimed property audits. The multi-state settlement relates to approximately 700,000 additional shares of the Company that were not claimed by residents of those states following the merger, which those states claimed were subject to escheat. While the Company disputes the states' claims, the Company determined that it was in its best interest to resolve the disputes and settle with 35 of the states. The remaining states have or may raise claims on approximately 400,000 additional shares that were not claimed following the merger by residents in those states. During the three months ended September 30, 2013, the Company recorded a $22.0 million charge related to the settlements it entered into and for potential future settlements with the remaining states. During the year ended December 31, 2014, the Company settled with the remaining states and made cash payments of $3.7 million to the settled states after completion of the required due diligence. During the year ended December 31, 2014, the Company released a $7.6 million of the reserve related to potential future settlements with the remaining states in connection with unexchanged promotional shares. As of December 31, 2014, the Company maintained estimated reserves related to the remaining settled states and made cash payments of $1.4 million to these settled states after completion of the required due diligence during the three months ending March 31, 2015.

See Note 1 to the accompanying unaudited condensed consolidated financial statements for further information on the unexchanged promotional shares contingency.

Income Taxes

Our income is generally taxed in the U.S., Canada, and U.K. Our income tax provisions reflect federal, state and country statutory rates applicable to our levels of worldwide income, adjusted to take into account expenses that are treated as having no recognizable tax benefit. Income tax expense was $1.8 million and $2.5 million for the three months ended March 31, 2015 and 2014, respectively. Our effective tax rate was 49% and 35% for the three months ended March 31, 2015 and 2014, respectively.

Our effective tax rate increased for the three months ended March 31, 2015 from the three months ended March 31, 2014, due primarily to a $565,000 income tax expense for unrecognized tax benefits related to certain state tax matters. We expect our effective tax rate to fluctuate in future periods depending on the geographic mix of our worldwide taxable income, total amount of expenses representing payments to former stockholders, losses or gains incurred by our operations in Canada and Europe, statutory tax rate changes that may occur, existing or new uncertain tax matters that may arise and require changes in tax reserves, and the need for valuation allowances on certain tax assets, if any.

U.S. income and foreign withholding taxes have not been provided on undistributed earnings for certain non-U.S. subsidiaries. The undistributed earnings on a book basis for those non-U.S. subsidiaries are approximately $6.1 million. The Company intends to reinvest these earnings indefinitely in its operations outside the U.S. If the undistributed earnings are remitted to the U.S., these amounts would be taxable in the U.S. at the current federal and state tax rates net of foreign tax credits. Also, depending on the jurisdiction any distribution may be subject to withholding taxes at rates applicable for that jurisdiction.

We file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. We are subject to U.S. federal and certain state tax examinations for years after 2009 and are subject to California tax examinations for years after 2005. Our 2009 and 2010 federal income tax returns are currently under examination, including a review of the impact of the sale of Asia Pacific business segment in 2009. During the year ended December 31, 2014, the Company received a Revenue Agent's Report (RAR) from the IRS, generally issued at the conclusion of an IRS examination. The RAR proposes an increase to our U.S. taxable income, which would result in additional federal tax, federal penalty and state tax expense totaling approximately $31.0 million, excluding interest and state penalties, if any. The Company did not make any adjustments to its liabilities for uncertain tax positions related to the RAR during the three months ended March 31, 2015 because the Company does not believe the IRS's valuation of Asia Pacific business segment assets is appropriate. If we are not able to resolve these proposed adjustments at the IRS examination level, we plan to pursue all available administrative and, if necessary, judicial remedies.

North America

	Three Months Ended March 31,	
	2015	2014
	(In thousands)	
Revenues	$24,713	$26,353
Income from operations	$2,080	$4,604
Income from operations as a % of revenues	8.4 %	17.5 %

North America net revenues decreased $1.6 million for the three months ended March 31, 2015 from the three months ended March 31, 2014 (see "Revenues" above). North America expenses increased $920,000 for the three months ended March 31, 2015 from the three months ended March 31, 2014. This increase was primarily due to a $1.0 million increase in member acquisition, and marketing costs.

Europe

	Three Months Ended March 31,	
	2015	2014
	(In thousands)	
Revenues	$11,779	$13,842
Income from operations	$1,722	$2,393
Income from operations as a % of revenues	14.6 %	17.3 %

Europe net revenues decreased $2.1 million for the three months ended March 31, 2015 from the three months ended March 31, 2014 (see "Revenues" above). Europe expenses decreased $1.4 million for the three months ended March 31, 2015 from the three months ended March 31, 2014. This decrease was primarily due to a $978,000 decrease in salary and employee related expense due in part to a decrease in headcount, an $860,000 decrease in search traffic acquisition costs, offset by a $832,000 increase in member acquisition and marketing costs.

Foreign currency movements relative to the U.S. dollar negatively impacted our income from our operations in Europe by approximately $57,000 for the three months ended March 31, 2015. Foreign currency movements relative to the U.S. dollar positively impacted our income from our operations in Europe by approximately $96,000 for the three months ended March 31, 2014.

Liquidity and Capital Resources

As of March 31, 2015, we had $54.0 million in cash and cash equivalents, of which $37.8 million was held outside the U.S. in certain of our foreign operations. If these assets are distributed to the U.S., we may be subject to additional U.S. taxes in certain circumstances. Cash and cash equivalents decreased from $54.8 million as of December 31, 2014 primarily as a result of the effect of exchange rate changes on cash and cash equivalents, offset by cash provided by operating activities as explained below. We expect that cash on hand will be sufficient to provide for working capital needs for at least the next twelve months.

	Three Months Ended March 31,	
	2015	2014
	(In thousands)	
Net cash provided by operating activities	$2,426	$1,751
Net cash used in investing activities	(184)	(819)
Net cash used in financing activities	—	(6,048)
Effect of exchange rate changes on cash and cash equivalents	(3,079)	(72)
Net decrease in cash and cash equivalents	$(837)	$(5,188)

Net cash provided by operating activities is net income adjusted for certain non-cash items and changes in assets and liabilities. Net cash provided by operating activities for the three months ended March 31, 2015 was $2.4 million which consisted of a net income of $1.9 million, adjustments for non-cash items of $833,000 and a $316,000 decrease in cash from changes in operating assets and liabilities. Adjustments for non-cash items primarily consisted of $771,000 of depreciation and amortization expense on property and equipment. In addition, the decrease in cash from changes in operating assets and liabilities primarily consisted of $1.8 million in accounts receivable, $1.4 million in accrued expenses for unexchanged promotional shares, offset by $1.0 million in income tax receivable, $930,000 in accounts payable and accrued expenses, $672,000 in other non-current liabilities, and $281,000 in prepaid expenses and other.

Cash paid for income tax net of refunds received during the three months ended March 31, 2015 and March 31, 2014 was $361,000 and $335,000, respectively.

Net cash used in investing activities for the three months ended March 31, 2015 and 2014, was $184,000 and $819,000, respectively. The cash used in investing activities for the three months ended March 31, 2015 was due to $184,000 in purchases of property and equipment. The cash used in investing activities for the three months ended March 31, 2014 was due to $1.0 million purchases of property and equipment, offset by $200,000 release of restricted cash.

Net cash used in financing activities for the three months ended March 31, 2015 and March 31, 2014, was nil and $6.0 million, respectively. Net cash used in financing activities for the three months ended March 31, 2014 was primarily due to repurchases of our common stock.

On April 21, 2011, the Company entered into an agreement which required a $20.0 million cash payment to the State of Delaware resolving all claims relating to the State of Delaware's unclaimed property review, which related primarily to unexchanged promotional shares contingency. In addition, based on multiple other state claims and settlements with the Company regarding the unexchanged promotional shares contingency, the Company made a $12.3 million cash payment to the settled states after completion of the required due diligence in the year ended December 31, 2013. The Company settled with the remaining states and made cash payments of $3.7 million to the settled states after completion of the required due diligence in the year ended December 31, 2014. During the year ended December 31, 2014, the Company released $7.6 million of the reserve related to potential future settlements with the remaining states in connection with unexchanged promotional shares based upon the actual settlements with the remaining states under more favorable terms than were estimated. As of December 31, 2014, the Company maintained estimated reserves related to the remaining settled states and made cash payments of $1.4 million to these settled states after completion of the required due diligence during the three months ended March 31, 2015.

Although the Company has settled the states unclaimed property claims with all states, the Company may still receive inquiries from certain potential Netsurfer promotional stockholders that had not provided their state of residence to the Company by April 25, 2004. Therefore, the Company is continuing its voluntary program under which it makes cash payments to individuals related to the promotional shares for individuals whose residence was unknown by the Company and who establish that they satisfied the conditions to receive shares of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. This voluntary program is not available for individuals whose promotional shares have been escheated to a state by the Company.

See Note 1 to the accompanying unaudited condensed consolidated financial statements for further information on the unexchanged promotional shares contingency and related cash program.

Our capital requirements depend on a number of factors, including market acceptance of our products and services, the amount of our resources we devote to the development of new products, cash payments to former stockholders of Travelzoo.com Corporation or to their original domicile state as unclaimed property, expansion of our operations, and the amount of resources we devote to promoting awareness of the Travelzoo and Fly.com brands. Since the inception of the program under which we make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period, we have incurred expenses of $2.9 million. While future payments for this program

are expected to decrease, the total cost of this program is still undeterminable because it is dependent on our stock price and on the number of valid requests ultimately received.
Consistent with our growth, we have experienced fluctuations in our cost of revenues, sales and marketing expenses and our general and administrative expenses, including increases in product development costs, and we anticipate that these increases will continue for the foreseeable future. We believe cash on hand will be sufficient to pay such costs for at least the next twelve months. In addition, we will continue to evaluate possible investments in businesses, products and technologies, the consummation of any of which would increase our capital requirements.

Although we currently believe that we have sufficient capital resources to meet our anticipated working capital and capital expenditure requirements for at least the next twelve months, unanticipated events and opportunities or a less favorable than expected development of our business with one or more of advertising formats may require us to sell additional equity or debt securities or establish new credit facilities to raise capital in order to meet our capital requirements.

If we sell additional equity or convertible debt securities, the sale could dilute the ownership of our existing stockholders. If we issue debt securities or establish a new credit facility, our fixed obligations could increase, and we may be required to agree to operating covenants that would restrict our operations. We cannot be sure that any such financing will be available in amounts or on terms acceptable to us.

If the development of our business is less favorable than expected, we may decide to significantly reduce the size of our operations and marketing expenses in certain markets with the objective of reducing cash outflow.

The information set forth under “Note 5 — Commitments and Contingencies” to the accompanying unaudited condensed consolidated financial statements included in Part I, Item 1 of this report is incorporated herein by reference.

Litigation and claims against the Company may result in legal defense costs, settlements or judgments that could have a material impact on our financial condition.

The following summarizes our principal contractual commitments as of March 31, 2015 (in thousands):

	2015	2016	2017	2018	2019	Thereafter	Total
Operating leases	$3,730	$4,185	$				