TRAVELZOO INC
Form 10-Q
May 05, 2016

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, 2016
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	36-4415727
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
590 Madison Avenue, 37th Floor New York, New York	10022
(Address of principal executive offices)	(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 May 4, 2016 was 14,108,518 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, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,807	$ 35,128
Accounts receivable, less allowance for doubtful accounts of $350 and $384 as of March 31, 2016 and December 31, 2015, respectively	17,414	16,398
Income tax receivable	436	1,356
Deposits	729	782
Deferred tax assets	1,543	1,230
Prepaid expenses and other	2,204	2,167
Total current assets	51,133	57,061
Deposits	484	501
Deferred tax assets	1,900	1,769
Restricted cash	1,182	1,328
Property and equipment, net	7,374	7,905
Other assets, net	—	15
Total assets	$ 62,073	$ 68,579
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 22,118	$ 23,655
Accrued expenses and other	9,915	10,140
Deferred revenue	1,117	1,085
Income tax payable	1,075	477
Note payable to related party	—	5,658
Total current liabilities	34,225	41,015
Long-term tax liabilities	3,007	3,000
Long-term deferred rent and other	2,965	3,177
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; 14,273 shares issued and outstanding and 14,518 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively)	148	150
Additional paid-in capital	6,009	7,759
Retained earnings	19,435	17,386
Accumulated other comprehensive loss	(3,716)	(3,908)
Total stockholders' equity	21,876	21,387
Total liabilities and stockholders' equity	$ 62,073	$ 68,579

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,	
	2016	2015
Revenues	$34,804	$39,145
Cost of revenues	4,009	4,546
Gross profit	30,795	34,599
Operating expenses:		
Sales and marketing	18,959	22,077
Product development	2,875	3,089
General and administrative	5,813	6,451
Total operating expenses	27,647	31,617
Income from operations	3,148	2,982
Other income (loss)	133	(446)
Income before income taxes	3,281	2,536
Income taxes	1,232	1,806
Net income	$2,049	$730
Basic net income per share	$0.14	$0.05
Diluted net income per share	$0.14	$0.05
Shares used in computing basic net income per share	14,425	14,730
Shares used in computing diluted net income per share	14,425	14,730

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,	
	2016	2015
Net income	$2,049	$730
Other comprehensive loss:		
Foreign currency translation adjustment	192	(2,145)
Total comprehensive income (loss)	$2,241	$(1,415)

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,	
	2016	2015
Cash flows from operating activities:		
Net income	$2,049	$730
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	642	823
Provision for losses on accounts receivable	8	27
Stock-based compensation	212	148
Deferred income tax	(443)	(222)
Net foreign currency effect	259	(111)
Changes in operating assets and liabilities:		
Accounts receivable	(1,025)	(1,880)
Deposits	63	(18)
Income tax receivable	921	851
Prepaid expenses and other	39	495
Accounts payable	(1,470)	496
Reserve for unexchanged promotional shares	—	(1,393)
Accrued expenses	(451)	564
Income tax payable	603	144
Other non-current liabilities	7	672
Net cash provided by operating activities	1,414	1,326
Cash flows from investing activities:		
Purchases of property and equipment	(145)	(189)
Release (purchase) of restricted cash	(5)	57
Net cash used in investing activities	(150)	(132)
Cash flows from financing activities:		
Acquisition of the Asia Pacific business	58	—
Payment of loan to related party	(5,658)	—
Proceeds from loan from related party	—	750
Decrease in bank overdraft	—	44
Repurchase of common stock	(1,908)	
Net cash provided by (used in) financing activities	(7,508)	794
Effect of exchange rate changes on cash and cash equivalents	(77)	(2,822)
Net decrease in cash and cash equivalents	(6,321)	(834)
Cash and cash equivalents at beginning of period	35,128	55,416
Cash and cash equivalents at end of period	$28,807	$54,582
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net	$50	$361
Cash paid for interest on related party loan	$110	$—

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 media commerce company. We inform over 28 million members in Asia Pacific, Europe and North America, 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.

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, 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 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.

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. ("Azzurro"). As of March 31, 2016, Azzurro is the Company's largest stockholder, holding approximately 52.1% of the Company's outstanding shares.

On August 20, 2015, we acquired the Travelzoo Asia Pacific business (“Asia Pacific”), which includes the Travelzoo businesses in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. This business was independently operated by Azzurro Capital Inc. under a licensing agreement with Travelzoo Inc. Azzurro was the majority stockholder of the Travelzoo Asia Pacific business. Travelzoo Inc. accounted for the acquisition as a common control transaction and change in reporting entity. The financial results for Travelzoo Inc. have been retrospectively adjusted to include the financial results of Asia Pacific in the current and prior periods as though the transaction occurred at the beginning of each period presented. The Asia Pacific assets and liabilities have been combined with Travelzoo Inc. at their carrying values as though the transaction occurred at the beginning of each period presented. The Asia Pacific transaction proceeds were reflected as an equity transaction, included in retained earnings, during the period the transaction occurred, which was in the year ended December 31, 2015. See Note 10 to the accompanying unaudited condensed consolidated financial statements for further information on the acquisition of Asia Pacific.

Certain prior period statement of operations amounts have been reclassified to conform to the current period presentation primarily due to the Company's allocation of facilities costs to all of its operating activities and separate disclosure of product development costs as shown below (in thousands):

	Three Months Ended March 31, 2015
Cost of revenues	$ 122
Sales and marketing	1,958
Product development	3,089
General and administrative	(5,169)
	$ —

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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 unaudited 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, 2015, included in the Company's Form 10-K filed with the SEC on March 14, 2016.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, including the recently acquired Asia Pacific subsidiaries reflected in the current and prior periods. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or any other future period, and the Company makes no representations related thereto.

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,	
	2016	2015
Basic net income per share:		
Net income	$2,049	$ 730
Weighted average common shares	14,425	14,730
Basic net income per share	$0.14	$ 0.05
Diluted net income per share:		
Net income	$2,049	$ 730
Weighted average common shares	14,425	14,730
Effect of dilutive securities: stock options	—	—
Diluted weighted average common shares	14,425	14,730
Diluted net income per share	$0.14	$ 0.05

For the three months ended March 31, 2016 and March 31, 2015, options to purchase 600,000 and 425,000 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, 2016 and December 31, 2015 (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, 2016				
Cash	$28,807	$ 28,807	$ —	$ —
Total cash	$28,807	$ 28,807	$ —	$ —
Certificates of deposit	$709	$ —	$ 709	$ —
Merchant bank deposit	745	745	—	—
Total restricted cash and cash equivalent	$1,454	$ 745	$ 709	$ —
Balance at December 31, 2015				
Cash	$35,128	$ 35,128	$ —	$ —
Total cash	$35,128	$ 35,128	$ —	$ —
Certificates of deposit	$708	$ —	$ 708	$ —
Merchant bank deposit	725	725	—	—
Total restricted cash and cash equivalent	$1,433	$ 725	$ 708	$ —

At March 31, 2016, and December 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.

At December 31, 2015, the note payable to related party was not measured at fair value; however, the Company believes that the carrying amount of these assets and liabilities was a reasonable estimate of their fair value because of its relatively short maturity and subsequent payment.

There have been no transfers and no changes in valuation methods for these assets or liabilities for the periods ended March 31, 2016 and December 31, 2015.

Note 4: Commitments and Contingencies

The Company was formed as a result of a combination and merger of entities founded by the Company's principal stockholder, Ralph Bartel. In 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. In 2004, two years following the effective date of the merger, certain promotional shares remained unexchanged. As the right to exchange these promotional shares expired, no additional shares were reserved for issuance. 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.

Beginning in 2010, the Company became subject to unclaimed property audits of various states in the United States related to the above unexchanged promotional shares. The Company recorded charges for the estimated settlements with these states of $20.0 million, $3.0 million and $22.0 million in 2011, 2012 and 2013, respectively. In 2014, the Company released $7.6 million of the reserve related to the completion of settlements with the states and in 2015 the Company paid the final settlements outstanding.

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Although the Company has settled the 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 charges in general and administrative expenses of $1,000 and $2,000 for these cash payments for the three months ended March 31, 2016 and 2015, respectively.

The total cost of this program cannot be reliably estimated 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 Australia, Canada, China, France, Germany, Hong Kong, Japan, Singapore, Spain, Taiwan, the U.K., and the U.S. under operating leases which expire between June 30, 2016 and November 30, 2024. The Company has purchase commitments which represent the minimum obligations the Company has under agreements with certain 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, 2016 (in thousands):

	2016	2017	2018	2019	2020	Thereafter	Total
Operating leases	$3,345	$4,168	$3,824	$3,560	$3,179	$ 8,483	$26,559
Purchase obligations	1,138	882	365	—	—	—	2,385
Total commitments	4,483	5,050	4,189	3,560	3,179	8,483	28,944

Local Deals and Getaways merchant payables included in accounts payable were $16.2 million and $19.1 million, as of March 31, 2016 and December 31, 2015, respectively.

Note 5: 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, Japan, Hong Kong, and the U.K. For the three months ended March 31, 2016 and 2015, the Company's effective tax rate was 38% and 71%, respectively. Our effective tax rate decreased for the three months ended March 31, 2016 from the corresponding three months ended March 31, 2015, due primarily to a $565,000 income tax expense for unrecognized tax benefits related to certain state tax matters for the three months ended March 31, 2015 and the change of geographic mix of taxable income for the three months ended March 31, 2016.

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, 2016 are approximately $9.3 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 $408,000 at March 31, 2016.

The Company maintains liabilities for uncertain tax positions. At March 31, 2016, the Company had approximately $2.1 million in total unrecognized tax benefits, which if recognized, would favorably affect the Company’s effective income tax rate.

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, 2016 and December 31, 2015, the Company had approximately $879,000 and $872,000, 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. 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 certain years after 2008 and is subject to California tax examinations for years after 2005. The material foreign jurisdictions where the Company is subject to potential examinations by tax authorities are the United Kingdom and Germany for tax years after 2011. The Company's 2009 federal income tax return is 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 the 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, 2016 because the Company does not believe the IRS’s valuation of the 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.

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Note 6: Accumulated Other Comprehensive Loss

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

	Three Months Ended March 31,	
	2016	2015
Beginning balance	$(3,908)	$(2,602)
Other comprehensive loss due to foreign currency translation, net of tax	192	(2,145)
Ending balance	$(3,716)	$(4,747)

There were no amounts reclassified from accumulated other comprehensive loss for the three months ended March 31, 2016 and 2015. Accumulated other comprehensive loss consists of foreign currency translation gains or losses.

Note 7: 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 became exercisable annually starting July 1, 2011. The options' original expiration date was November 2019. As of March 31, 2016, 300,000 of these options were forfeited upon the departure of the executive.

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 became exercisable annually starting January 23, 2013. The options expire in January 2022. As of March 31, 2016, 50,000 options were outstanding and 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, 2016 and 2015 related to the outstanding stock option grant were $5,000 and $60,000, respectively. As of March 31, 2016, there was no unrecognized stock-based compensation expense relating to these options.

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 became exercisable annually starting July 1, 2015. The options' original expiration date was July 2023. As of March 31, 2016, 25,000 options were forfeited and 50,000 of these options were canceled upon the departure of the executive.

In September 2015, the Company granted an executive stock options to purchase 400,000 shares of common stock with an exercise price of $8.07, of which 50,000 options became exercisable quarterly starting March 31, 2016. The options expire in September 2025. As of March 31, 2016, 400,000 options were outstanding and 50,000 of these options were vested. Total stock-based compensation for the three months ended March 31, 2016, related to this option grant was $196,000. As of March 31, 2016, there was approximately $1.4 million of unrecognized stock-based compensation expense relating to these options. This amount is expected to be recognized over 1.8 years. See Note 10 to the accompanying unaudited condensed consolidated financial statements for further information.

In March 2016, the Company granted certain executives stock options to purchase 150,000 shares of common stock with an exercise price of $8.55, of which 37,500 options vest and become exercisable annually starting on March 7, 2017. The options expire in March 2026. As of March 31, 2016, 150,000 options were outstanding and none of these options were vested. Total stock-based compensation for the three months ended March 31, 2016, related to these option grants was $11,000. As of March 31, 2016, there was approximately $698,000 of unrecognized stock-based compensation expense relating to these options. This amount is expected to be recognized over 3.9 years.

Note 8: Stock Repurchase Program

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

In January 2014, the Company announced a stock repurchase program authorizing the repurchase of up to 500,000 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. During the year ended December 31, 2015, the Company repurchased 212,000 shares of common stock for an aggregate purchase price of $1.7 million. The shares repurchased under this program were retired as of December 31, 2015. There were 56,000 shares remaining to be repurchased under this program as of December 31, 2015, which were repurchased during the three months ended March 31, 2016.

In February 2016, 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 three months ended March 31, 2016, the Company repurchased 246,000 shares of common stock, including the 56,000 shares from the previous stock repurchase program, for an aggregate purchase price of $2.0 million, which were retired as of March 31, 2016. There were 810,000 shares remaining to be repurchased under this program as of March 31, 2016.

Note 9: Segment Reporting and Significant Customer Information

The Company manages its business geographically and has three reportable operating segments: Asia Pacific, Europe and North America. Asia Pacific consists of the Company's operations in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. Europe consists of the Company's operations in France, Germany, Spain, and the U.K. North America consists of the Company's operations in Canada and the U.S.

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, 2016	Asia Pacific	Europe	North America	Other	Consolidated
Revenues from unaffiliated customers	$2,259	$10,966	$21,579	$ —	$ 34,804
Intersegment revenues	1	(74)	73	—	—
Total net revenues	2,260	10,892	21,652	—	34,804
Operating income (loss)	$(1,044)	$2,094	$2,098	$ —	$ 3,148

Three Months Ended March 31, 2015	Asia Pacific	Europe	North America	Other	Consolidated
Revenues from unaffiliated customers	$2,653	$11,779	$24,713	$ —	$ 39,145
Intersegment revenues	(5)	(217)	222	—	—
Total net revenues	2,648	11,562	24,935	—	39,145
Operating income (loss)	$(833)	$1,729	$2,086	$ —	$ 2,982

As of March 31, 2016	Asia Pacific	Europe	North America	Elimination	Consolidated
Long-lived assets	$322	$795	$6,257	$—	$ 7,374
Total assets	$4,410	$48,499	$73,647	$(64,483)	$ 62,073

As of December 31, 2015	Asia Pacific	Europe	North America	Elimination	Consolidated
Long-lived assets	$369	$899	$6,652	$—	$ 7,920
Total assets	$5,845	$54,452	$71,626	$(63,344)	$ 68,579

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, 2016 and 2015, the Company did not have any customers that accounted for 10% or more of revenue. As of March 31, 2016 and December 31, 2015, the Company had one customer that accounted for 16% and 15%, 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 platform. 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,	
	2016	2015
Asia Pacific		
Travel	2,027	2,260
Search	5	11
Local	228	377
Total Asia Pacific revenues	2,260	2,648
Europe		
Travel	$9,007	$9,449
Search	333	640
Local	1,552	1,473
Total Europe revenues	$10,892	$11,562
North America		
Travel	$14,757	$16,040
Search	3,638	4,738
Local	3,257	4,157
Total North America revenues	$21,652	$24,935
Consolidated		
Travel	$25,791	$27,749
Search	3,976	5,389
Local	5,037	6,007
Total revenues	$34,804	$39,145

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,	
	2016	2015
Revenue		
United States	$20,302	$23,431
United Kingdom	7,121	7,871
Rest of the world	7,381	7,843
Total revenues	$34,804	$39,145

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

	As of March 31, 2016	As of December 31, 2015
United States	$5,758	$ 6,167
Rest of the world	1,616	1,753
Total long lived assets	$7,374	$ 7,920

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Note 10: Related Party Transactions

On August 20, 2015, Travelzoo acquired the Travelzoo Asia Pacific business (“Asia Pacific”), which includes the Travelzoo businesses in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. This business was independently operated by Azzurro Capital Inc. ("Azzurro") under a licensing agreement with Travelzoo Inc. The Company held an option right to acquire Asia Pacific at fair market value as determined by a third party valuation expert. Under the terms of the definitive acquisition agreement, Travelzoo (Europe) Limited, a United Kingdom subsidiary of the Company, was authorized by the Company to exercise the option right to acquire Asia Pacific for a fair market transaction value of $22.6 million, subject to a working capital adjustment, using available cash of $17.0 million and a promissory note of $5.7 million with a maturity date of three years. In January 2016, Travelzoo (Europe) Limited paid off the promissory note of $5.7 million using available cash in Europe.

The Company’s board of directors established a special committee (the “Special Committee”), consisting of independent and disinterested directors and provided it with the exclusive power and authority to determine whether any potential transaction to acquire Asia Pacific was advisable, fair to and in the best interests of the Company's stockholders other than Azzurro Capital Inc., the principal stockholder of Travelzoo Inc. The Special Committee engaged independent legal counsel and an independent financial advisor, Stout Risius Ross, Inc. (“SRR”). The Special Committee obtained the right to select its own independent financial advisor, SRR, to independently determine the fair market value of Asia Pacific to be used as the option exercise price and received an opinion from SRR regarding the fairness of the Asia Pacific transaction from a financial point of view. SRR determined that $22.6 million represented the fair market value of Asia Pacific to be used as the option exercise price based upon the use of established valuation methodologies. The Special Committee, which was composed solely of independent and disinterested directors, unanimously approved the acquisition of Asia Pacific at the fair market value option exercise price with the assistance of its independent legal and financial advisors.

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, 2016, Azzurro is the Company's largest stockholder, holding approximately 52.1% of the Company’s outstanding shares.

Since Azzurro Capital Inc. had a controlling interest in both Travelzoo Inc. and the Travelzoo Asia Pacific business at the time of the transaction and in prior periods, this transaction is accounted for as a common control transaction and a change in reporting entity for the Company. The financial results for Travelzoo Inc. have been retrospectively adjusted to include the financial results of Asia Pacific in the current and prior periods as though the transaction occurred at the beginning of each period presented, including the following adjustments:

	Three Months Ended March 31,	
	2016	2015
Revenue	$2,273	$2,661
Operating loss	$(1,043)	$(834)
Net Loss	$(997)	$(1,179)
Other Comprehensive income	$6	$124
Basic and diluted earnings per share	$(0.07)	$(0.05)

The Asia Pacific assets and liabilities have been combined with Travelzoo Inc. at their carrying values as though the transaction occurred at the beginning of each period presented. At March 31, 2016, and December 31, 2015, Asia Pacific net liabilities, total assets minus total liabilities, were $7.8 million, and $6.8 million , respectively.

The Asia Pacific transaction proceeds of $22.6 million were reflected as an equity transaction, included in retained earnings, during the period the transaction occurred, which was in the year ended December 31, 2015.

Travelzoo (Europe) Limited, a United Kingdom subsidiary of the Company, acquired the Asia Pacific business, which includes certain customary seller indemnifications, through the acquisition of Travelzoo (Asia) Limited, including its wholly owned subsidiaries, and Travelzoo Japan KK. All significant intercompany accounts and transactions between Travelzoo Inc. and the acquired Asia Pacific entities have been eliminated for all periods presented.

In November 2014, Azzurro provided a loan to Asia Pacific of $1.0 million with a stated interest rate of 8%. There was a $1.0 million loan and $5,000 accrued interest due to Azzurro as of December 31, 2014. From January 1, 2015 to August 20, 2015, Azzurro provided loans to Asia Pacific amounting to $2.2 million with a stated interest rate of 10%. In September 2015, the Company paid the due and outstanding principal loan amount of $3.3 million and accrued interest of $128,000.

On August 20, 2015, as part of the transaction proceeds Travelzoo (Europe) Limited issued a promissory note to Azzurro with a principal amount of $5.7 million, with a maturity date of August 20, 2018 and the ability to pay off principal prior to this maturity date with no prepayment penalty and a stated interest rate of 7%, which is due and payable on a quarterly basis. There were $5.7 million loans due to Azzurro as of December 31, 2015. In January 2016, Travelzoo (Europe) Limited paid off the full amount of the loan of $5.7 million and interest of $110,000.

On September 28, 2015, Holger Bartel, Executive Chairman and Chairman of the Board of Directors, was granted 400,000 stock options that vest through December 31, 2017 in connection with his appointment to the role of Global Chief Executive Officer. See Note 7 to the accompanying unaudited condensed consolidated financial statements for further information.

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 media commerce company. We inform over 28 million members in Asia Pacific, Europe and North America, 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.

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, 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 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 August 20, 2015 we acquired the Travelzoo Asia Pacific business ("Asia Pacific"), which includes the Travelzoo businesses in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. This business was independently operated by Azzurro under a licensing agreement with Travelzoo Inc. Azzurro was the majority stockholder of the Travelzoo Asia Pacific business. Travelzoo Inc. accounted for this transaction as a common control transaction and change in reporting entity. The financial results for Travelzoo Inc. have been retrospectively adjusted to include the financial results of Asia Pacific in the current and prior periods as though the transaction occurred at the beginning of the each period presented. The Asia Pacific assets and liabilities have been combined with Travelzoo Inc. at their carrying values as though the transaction occurred at the beginning of each period presented. The Asia Pacific transaction proceeds were reflected as an equity transaction, included in retained earnings, during the period the transaction occurred, which was in the year ended December 31, 2015. See Note 10 to the accompanying unaudited condensed consolidated financial statements for further information on the acquisition of Asia Pacific.

Certain prior period statement of operations amounts have been reclassified to conform to the current period presentation primarily due to the Company's allocation of facilities costs to all of its operating activities and separate disclosure of product development costs. See Note 1 to the accompanying unaudited condensed consolidated financial statements for further information.

More than 2,000 companies use our services, including Air New Zealand, Apple Vacations, British Airways, Cathay Pacific Airways, Expedia, Fairmont Hotels and Resorts, Hawaiian Airlines, Iceland Air, InterContinental Hotels

Group, Interstate Hotels & Resorts, Lufthansa, Key Tours International, Liberty Travel, Princess Cruises, Singapore Airlines, Solar Tours, Starwood Hotels & Resorts Worldwide, Travelocity, United Airlines, Vacation Express and Virgin Atlantic.

We have three operating segments based on geographic regions: Asia Pacific, Europe and North America. Asia Pacific consists of our operations in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. Europe consists of our operations in France, Germany, Spain, and the U.K. North America consists of our operations in Canada and the U.S. 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, hotel booking stays 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, upon hotel booking stays and upon the sale of the vouchers or other items sold.

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, our ability to have sufficient supply of hotels offered at competitive 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, and the decline in consumer demand for vouchers. 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, and 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 an 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 continuously reviewing the performance of these products, which has and will result in reduced traffic acquisition spend for these products and may result in merging the products, discontinuing or replacing one or both of them. Challenges with traffic acquisition from search engines and poor monetization on mobile devices have led to declines in Search revenue. Given these factors impacting our Search products, revenue from our Search products are expected 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 hotel revenue as we expand the use of our hotel 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. In the last several years, 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 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 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 will 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 trends 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, the regions we choose to acquire new members and the relative costs for that region, 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. For example, we recently acquired our Asia Pacific business, and we intend on increasing our investment in audience in this region. Due to the continued desire to grow our business in Asia Pacific, Europe and North America, 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 product development 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. Product development changes may lead to reductions of revenue based on changes in the way that we present our deals to our audience. We expect our efforts on developing our product and services will continue to be a focus in the future, which may lead to increased product development expenses. This increase in expense may be the result of an increase in headcount, the compensation related to existing headcount and the increased use of professional services. We expect our continued expansion into foreign markets and development of new advertising formats to result in a significant additional increase in our product development expenses. We expect to incur additional costs related to the development of our hotel platform capabilities, which we are developing, in part, to address the shift to mobile devices. We also may increase our investment in product development to ensure our products are suited for different regions such as Asia Pacific. In addition, we expect to incur additional costs related to the development of our search capabilities of our website and mobile applications.

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 to result in an 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.

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 in 2009 and the acquisition of our Asia Pacific business in 2015. 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. In addition, from 2007 through 2009 we began operations in Asia Pacific, including in Australia, China, Hong Kong, Japan, Taiwan, and Southeast Asia. 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 platform to assist in our development of a product to better serve hotels and to facilitate the development of our hotel 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,			
	2016		2015	
Revenues	100.0	%	100.0	%
Cost of revenues	11.5		11.6	
Gross profit	88.5		88.4	
Operating expenses:				
Sales and marketing	54.5		56.4	
Product development	8.3		7.9	
General and administrative	16.7		16.5	
Total operating expenses	79.5		80.8	
Income from operations	9.0		7.6	
Other income (expense)	0.4		(1.1	)
Income before income taxes	9.4		6.5	
Income taxes	3.5		4.6	
Net income	5.9	%	1.9	%

Operating Metrics

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

	Three Months Ended March 31, 2016	2015
Asia Pacific		
Total members (1)	3,549,000	3,482,000
Average cost per acquisition of a new member	$ 2.62	$ 0.08
Revenue per member (2)	$ 2.60	$ 3.00
Revenue per employee (3)	$ 102,000	$ 97,000
Mobile application downloads	589,000	494,000
Social media followers	389,000	371,000
Europe		
Total members (1)	8,054,000	7,458,000
Average cost per acquisition of a new member	$ 3.21	$ 4.41
Revenue per member (2)	$ 5.54	$ 6.41
Revenue per employee (3)	$ 292,000	$ 304,000
Mobile application downloads	1,476,000	1,265,000
Social media followers	630,000	525,000
North America		
Total members (1)	17,286,000	17,171,000
Average cost per acquisition of a new member	$ 2.27	$ 2.29
Revenue per member (2)	$ 5.04	$ 5.87
Revenue per employee (3)	$ 385,000	$ 388,000
Mobile application downloads	2,834,000	2,424,000
Social media followers	2,360,000	1,936,000
Consolidated		
Total members (1)	28,741,000	27,974,000
Average cost per acquisition of a new member	$ 2.64	$ 2.88
Revenue per member (2)	$ 4.90	$ 5.66
Revenue per employee (3)	$ 301,000	$ 302,000
Mobile application downloads	4,900,000	4,183,000
Social media followers	3,379,000	2,832,000

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

(3) 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 platform. 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,	
	2016	2015
Asia Pacific		
Travel	2,027	2,260
Search	5	11
Local	228	377
Total Asia Pacific revenues	2,260	2,648
Europe		
Travel	$9,007	$9,449
Search	333	640
Local	1,552	1,473
Total Europe revenues	$10,892	$11,562
North America		
Travel	$14,757	$16,040
Search	3,638	4,738
Local	3,257	4,157
Total North America revenues	$21,652	$24,935
Travel	$25,791	$27,749
Search	3,976	5,389
Local	5,037	6,007
Total revenues	$34,804	$39,145

Asia Pacific

Asia Pacific revenues decreased $388,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. The decrease was primarily due to a $224,000 decrease in Travel revenues, a $143,000 decrease in Local revenues and a $76,000 negative impact from foreign currency movements relative to the U.S. dollar. The decrease in Travel revenue of $224,000 was primarily due to the decreased number of emails sent and paid clicks. The decrease in Local revenues of $143,000 was primarily due to the decreased number of Local Deals vouchers sold.

Europe

Europe revenues decreased $670,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. This decrease was primarily due to a $502,000 negative impact from foreign currency movements relative to the U.S. dollar, a $279,000 decrease in Search revenues, offset by a $148,000 increase in Local revenues. The decrease in Search revenue of $279,000 was primarily due to the decreased number of clicks that generate revenue as a result of decreased spending on traffic acquisition. The increase in Local revenue of $148,000 was primarily due to an increased number of Local Deals vouchers sold.

North America

North America revenues decreased $3.3 million for the three months ended March 31, 2016 from the three months ended March 31, 2015. This decrease was primarily due to the decrease in Travel, Search and Local revenues. The decrease in Travel revenue of $1.3 million was primarily due to the decreased number of Getaways vouchers sold and paid clicks. The decrease in Search revenue of $1.1 million was primarily due to the decreased number of clicks that generate revenue as a result of decreased spending on traffic acquisition. The decrease in Local revenues of $900,000 was primarily due to the decreased number of Local Deals vouchers sold. The North America revenue decrease includes a $145,000 negative impact from foreign currency movement relative to the U.S. dollar.

For the three months ended March 31, 2016 and 2015, none of our customers accounted for 10% or more of our revenue.

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 and facilities costs. Cost of revenues was $4.0 million and $4.5 million for the three months ended March 31, 2016 and March 31, 2015, respectively.

Cost of revenue decreased $537,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. This decrease was primarily due to a $425,000 decrease 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, public relations expenses and facilities costs. Sales and marketing expenses were $19.0 million and $22.1 million for the three months ended March 31, 2016 and 2015, respectively. For the three months ended March 31, 2016 and 2015, advertising expenses accounted for 34% 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 decreased $3.1 million for the three months ended March 31, 2016 from the three months ended March 31, 2015. The decrease was primarily due to a $1.9 million decrease in salary and employee related expenses due in part to a decrease in headcount, and a $527,000 planned decrease in Search traffic acquisition and other marketing costs.

Product Development

Product development expenses consist primarily of compensation for software development staff, fees for professional services, software maintenance and amortization, and facilities costs. Product development expenses were $2.9 million and $3.1 million for the three months ended March 31, 2016 and 2015, respectively.

Product development expenses decreased $214,000 for three months ended March 31, 2016 from the three months ended March 31, 2015. The decrease was primarily due to 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, bad debt expense, amortization of intangible assets, general office expense and facilities costs. General and administrative expenses were $5.8 million and $6.5 million for the three months ended March 31, 2016 and 2015, respectively.

General and administrative expenses decreased $638,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. The decrease was primarily due to decrease in salary and employee related expenses due in part to a decrease in headcount.

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 $1.2 million and $1.8 million for the three months ended March 31, 2016 and 2015, respectively. Our effective tax rate was 38% and 71% for the three months ended March 31, 2016 and 2015, respectively.

Our effective tax rate decreased for the three months ended March 31, 2016 from the three months ended March 31, 2015, due primarily to a $565,000 income tax expense for unrecognized tax benefits related to certain state tax matters for the three months ended March 31, 2015 and the change of geographic mix of taxable income for the three months ended March 31, 2016. We expect our effective tax rate to fluctuate in future periods depending on the geographic mix of our worldwide taxable income, losses or gains incurred by our operations in Asia Pacific, 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, the use of accumulated losses to offset current taxable income in Asia Pacific 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 $9.3 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 2008 and are subject to California tax examinations for years after 2005. These examinations may lead to ordinary course adjustments or proposed adjustments to our taxes or our net operating income. 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. In connection with this examination, 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. See Note 5 to the accompanying unaudited condensed consolidated financial statements for further information.

Asia Pacific

	Three Months Ended March 31,	
	2016	2015
	(In thousands)	
Revenues	2,260	2,648
Income from operations	$(1,044)	$(833)
Income from operations as a % of revenues	(46.2)%	(31.5)%

Asia Pacific net revenues decreased $388,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015 (see “Revenues” above). Asia Pacific expenses decreased $177,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. This decrease was primarily due to a $449,000 decrease in salary and employee related expense due in part to a decrease in headcount, offset by a $253,000 increase in member acquisition costs.

Foreign currency movements relative to the U.S. dollar positively impacted our local currency loss from our operations in Asia Pacific by approximately $68,000 for the three months ended March 31, 2016. Foreign currency movements relative to the U.S. dollar negatively impacted our loss from our operations in Asia Pacific by approximately $8,000 for the three months ended March 31, 2015.

Europe

	Three Months Ended March 31,	
	2016	2015
	(In thousands)	
Revenues	10,892	11,562
Income from operations	$2,094	$1,729
Income from operations as a % of revenues	19.2 %	15.0 %

Europe net revenues decreased $670,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015 (see “Revenues” above). Europe expenses decreased $975,000 for the three months ended March 31, 2016 from the three months ended March 31, 2015. This decrease was primarily due to a $426,000 decrease in salary and employee related expense due in part to a decrease in headcount and a $367,000 decrease in search traffic acquisition, member acquisition and marketing costs.

Foreign currency movements relative to the U.S. dollar negatively impacted our local currency income from our operations in Europe by approximately $136,000 for the three months ended March 31, 2016. 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.

North America

	Three Months Ended March 31,	
	2016	2015
	(In thousands)	
Revenues	21,652	24,935
Income from operations		