

HouseValues, Inc.  
Form 10-Q  
May 05, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For The Quarter Ended March 31, 2005

OR

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

Commission File Number: 000-51032

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**HouseValues, Inc.**

(Exact name of registrant as specified in its charter)

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

**91-1982679**  
(IRS Employer  
Identification No.)

**11332 NE 122<sup>nd</sup> Way, Kirkland, WA 98034**

(Address of principal executive offices, including zip code)

**(425) 952-5500**

(Registrant's telephone number, including area code)

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

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

As of April 18, 2005, there were outstanding 25,166,511 shares of the registrant's common stock, \$0.001 par value, which is the only class of common stock of the registrant.

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**HOUSEVALUES, INC.**

**FORM 10-Q**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****HouseValues, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share data)****(unaudited)**

	<b>Quarters ended</b>	
	<b>March 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>_____</b>	<b>_____</b>
Revenues	\$ 17,619	\$ 9,323
Expenses:		
Sales and marketing	8,622	4,315
Technology and product development	1,234	723
General and administrative	2,770	1,323
Depreciation and amortization of property and equipment (1)	354	198
Amortization of intangible assets	152	163
Stock-based compensation (2)	297	21
	<b>_____</b>	<b>_____</b>
Total expenses	13,429	6,743
	<b>_____</b>	<b>_____</b>
Income from operations	4,190	2,580
Interest income	318	17
	<b>_____</b>	<b>_____</b>
Income before income tax expense	4,508	2,597
Income tax expense	1,578	913
	<b>_____</b>	<b>_____</b>
Net income	\$ 2,930	\$ 1,684
	<b>_____</b>	<b>_____</b>
Net income per share:		
Basic	\$ 0.12	\$ 0.09
	<b>_____</b>	<b>_____</b>
Diluted	\$ 0.11	\$ 0.08
	<b>_____</b>	<b>_____</b>

(1) Depreciation and amortization of property and equipment is allocated as follows:

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	<u>2005</u>	<u>2004</u>
Technology and product development	\$ 113	\$ 91
General and administrative	241	107
	<u>          </u>	<u>          </u>
	<u>\$ 354</u>	<u>\$ 198</u>

(2) Stock-based compensation is allocated as follows:

	<u>2005</u>	<u>2004</u>
Sales and marketing	\$ 66	\$ 6
Technology and product development	57	10
General and administrative	174	5
	<u>          </u>	<u>          </u>
	<u>\$ 297</u>	<u>\$ 21</u>

*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****HouseValues, Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)****(unaudited)**

	<b>March 31,</b>	<b>December 31,</b>
	<b>2005</b>	<b>2004</b>
	<u>          </u>	<u>          </u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 58,010	\$ 57,562
Short-term investments	19,315	17,316
Accounts receivable, net of allowance of \$114 and \$95, respectively	349	84
Prepaid expenses and other assets	1,012	1,245
Deferred income taxes	483	222
Other current assets	1,495	1,605
	<u>          </u>	<u>          </u>
Total current assets	80,664	78,034
Property and equipment, net of accumulated depreciation of \$2,398 and \$2,051	4,356	3,702
Goodwill	1,329	948
Intangible assets, net of accumulated amortization of \$1,378 and \$1,225	1,319	1,430
Other noncurrent assets	523	450
	<u>          </u>	<u>          </u>
Total assets	\$ 88,191	\$ 84,564
	<u>          </u>	<u>          </u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,294	\$ 1,167
Accrued compensation and benefits	2,205	2,407
Accrued expenses and other current liabilities	2,876	3,706
Deferred rent, current portion	248	261
Deferred revenue	1,140	1,014
Income taxes payable	999	103
	<u>          </u>	<u>          </u>
Total current liabilities	8,762	8,658
Deferred rent, less current portion	1,384	1,306
	<u>          </u>	<u>          </u>
Total liabilities	10,146	9,964
Shareholders' equity:		
Common stock, par value \$0.001 per share, stated at amounts paid in; authorized 120,000,000 shares; issued and outstanding 25,085,294 and 24,935,000 shares at March 31, 2005 and December 31, 2004, respectively	68,717	68,631
Deferred stock-based compensation	(4,195)	(4,624)
Retained earnings	13,523	10,593
	<u>          </u>	<u>          </u>
Total shareholders' equity	78,045	74,600
	<u>          </u>	<u>          </u>
Total liabilities and shareholders' equity	\$ 88,191	\$ 84,564



*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****HouseValues, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(unaudited)**

	<b>Quarters ended</b>	
	<b>March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,930	\$ 1,684
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	354	198
Amortization of intangible assets	152	163
Stock-based compensation	297	21
Deferred income tax benefit	(334)	(64)
Changes in certain assets and liabilities, net of SOAR Solutions, Inc. acquisition		
Accounts receivable	(265)	4
Prepaid expenses and other assets	233	(11)
Other current assets	110	
Accounts payable	44	(523)
Accrued compensation and benefits	(202)	(31)
Accrued expenses and other current liabilities	(42)	13
Deferred rent	65	
Deferred revenue	126	194
Income taxes payable	896	412
	<u>4,364</u>	<u>2,060</u>
Net cash provided by operating activities	4,364	2,060
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments	(6,299)	
Sales of short-term investments	4,300	
Purchases of property and equipment	(1,476)	(153)
Purchases of intangible assets	(41)	
Acquisition of SOAR Solutions, Inc., net of cash acquired		(11)
	<u>(3,516)</u>	<u>(164)</u>
Net cash used in investing activities	(3,516)	(164)
<b>Cash flows from financing activities:</b>		
Issuance costs related to the sale of common stock	(618)	
Proceeds from exercises of stock options and warrants	218	179
Issuance of shareholder note for option exercise		(61)
	<u>(400)</u>	<u>118</u>
Net cash (used in) provided by financing activities	(400)	118
Net increase in cash and cash equivalents	448	2,014



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Cash and cash equivalents at beginning of period	<u>57,562</u>	<u>7,181</u>
Cash and cash equivalents at end of period	<u>\$ 58,010</u>	<u>\$ 9,195</u>

*See accompanying notes to condensed consolidated financial statements.*

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**HouseValues, Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the quarters ended March 31, 2005 and 2004

(unaudited)

**Note 1 - Summary of Significant Accounting Policies**

*Nature of Operations*

HouseValues, Inc. was incorporated in Washington in May 1999. HouseValues provides an innovative service offering that enables real estate professionals to capture and cultivate leads, and convert these leads into closed transactions. The integrated service offering combines leads generated from HouseValues.com and JustListed.com web sites with an online prospect management system and personalized coaching and training to help agent customers increase lead conversion.

*Initial Public Offering*

On December 9, 2004, the Company completed its initial public offering and its stock commenced trading on December 10, 2004.

*Basis of Presentation*

The consolidated financial statements are unaudited and include the financial statements of HouseValues, Inc. and its subsidiaries (collectively, the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. The year end balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. In management's opinion all normal recurring adjustments which are necessary for the fair presentation of the results for the interim periods are reflected herein. Operating results for the quarter ended March 31, 2005 are not necessarily indicative of results to be expected for a full year.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

***Stock-Based Compensation***

The Company applies the intrinsic-value based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion 25*. Under this method, compensation expense related to employee stock options is recorded if, on the date of grant, the fair value of the underlying stock exceeds the exercise price. Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123 and SFAS No. 148, *Accounting for Stock-Based Compensation, Transition and Disclosure*, the Company has elected to continue to apply the intrinsic-value based method of accounting see *Recent Accounting Pronouncements*.

**Table of Contents****HouseValues, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the quarters ended March 31, 2005 and 2004

(unaudited)

**Note 1 - Summary of Significant Accounting Policies (Cont.)**

The following table illustrates the effect on net income if the fair value based method as prescribed by SFAS No. 123 had been applied to all outstanding awards in each period (in thousands, except per share data):

	<b>Quarters ended</b>	
	<b>March 31,</b>	
	<b>2005</b>	<b>2004</b>
Net income, as reported	\$ 2,930	\$ 1,684
Add: Stock-based employee compensation included in reported net earnings, net of tax	203	21
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(311)	(42)
Pro forma net income available to shareholders	\$ 2,822	\$ 1,663
Earnings per share		
Basic as reported	\$ 0.12	\$ 0.09
Diluted as reported	\$ 0.11	\$ 0.08
Basic pro forma	\$ 0.11	\$ 0.09
Diluted pro forma	\$ 0.11	\$ 0.08

The value of each employee option granted through March 31, 2005 was estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for options granted during the quarter ended March 31, 2005: risk-free interest rate of 4.36%, expected volatility of 100%, expected life of 4 years and dividend yield of 0%. The weighted-average fair value of options granted during that quarter ended March 31, 2005 was \$9.34.

***Recent Accounting Pronouncements***

In December 2004, the Financial Accounting Standards Board issued Statement Number 123 (revised 2004) ( SFAS 123R ), Share-Based Payments. SFAS 123R requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, such as stock options granted to employees. The Company is required to apply SFAS 123R on a modified prospective method. Under this method, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, the Company may elect to adopt SFAS 123R by restating previously

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issued financial statements, basing the amounts on the expense previously calculated and reported in their pro forma disclosures that had been required by SFAS 123. FAS 123R is effective for the Company in the first quarter of 2006, as recently permitted by the Securities and Exchange Commission. Management has not completed its evaluation of the effect that SFAS 123R will have, but believes that when adopted it will increase stock based compensation expense and reduce net income.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107. SAB 107 expresses the views of the SEC staff regarding the interaction of FAS 123R and certain SEC rules and regulations and provides the SEC staff's view regarding the valuation of share-based payment arrangements for public companies. Management is assessing the impact of SAB 107 in conjunction with their evaluation of the impact of SFAS 123R.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the quarters ended March 31, 2005 and 2004

(unaudited)

**Note 2 - Acquisitions**

In June 2003, the Company acquired all of the outstanding stock of Soar Solutions, Inc., a real-estate services company, in exchange for \$985,000 in cash; an earn-out arrangement equal to 5% of specified gross customer recei