TRAVELZOO INC
Form 10-Q
August 11, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

or

o **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 þ No o

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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of Travelzoo common stock outstanding as of August 5, 2008 was 14,285,479 shares.

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PART I FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

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

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,017	$ 22,641
Accounts receivable, less allowance for doubtful accounts of $265 and $290 as of June 30, 2008 and December 31, 2007, respectively	11,566	9,969
Deposits	202	272
Prepaid expenses and other current assets	1,901	1,982
Deferred income taxes	1,393	1,393
Total current assets	36,079	36,257
Deposits, less current portion	378	349
Restricted cash	875	
Property and equipment, net	2,156	622
Intangible assets, net	53	58
Total assets	$ 39,541	$ 37,286
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,707	$ 4,960
Accrued expenses	5,265	4,608
Deferred revenue	756	450
Deferred rent	30	37
Total current liabilities	13,758	10,055
Long-term tax liabilities	1,289	1,256
Deferred rent, less current portion	795	73
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.01 par value (40,000 shares authorized; 14,285 and 14,250 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively	143	143
Additional paid-in capital	185	
Retained earnings	23,740	25,939

Accumulated other comprehensive loss		(369)		(180)
Total stockholders equity		23,699		25,902
Total liabilities and stockholders equity	$	39,541	$	37,286

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Revenues	$ 21,769	$ 20,115	$ 42,718	$ 39,855
Cost of revenues	637	225	1,166	374
Gross profit	21,132	19,890	41,552	39,481
Operating expenses:				
Sales and marketing	12,520	10,745	25,914	20,062
General and administrative	6,930	3,392	12,676	6,189
Total operating expenses	19,450	14,137	38,590	26,251
Income from operations	1,682	5,753	2,962	13,230
Other income and expense:				
Interest income	77	428	213	792
Gain (loss) on foreign currency	(6)	36	145	35
Income before income taxes	1,753	6,217	3,320	14,057
Income taxes	2,946	3,371	5,519	7,148
Net income (loss)	$ (1,193)	$ 2,846	$ (2,199)	$ 6,909
Basic net income (loss) per share	$ (0.08)	$ 0.19	$ (0.15)	$ 0.45
Diluted net income (loss) per share	$ (0.08)	$ 0.17	$ (0.15)	$ 0.42
Shares used in computing basic net income (loss) per share	14,269	15,250	14,260	15,250
Shares used in computing diluted net income (loss) per share	14,269	16,482	14,260	16,481

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended June 30, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ (2,199)	$ 6,909
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	233	79
Provision for losses on accounts receivable	66	(8)
Tax benefit from exercise of stock options	(110)	
Changes in operating assets and liabilities:		
Accounts receivable	(1,657)	(1,235)
Deposits	42	(67)
Prepaid expenses and other current assets	196	(815)
Accounts payable	2,332	3,580
Accrued expenses	629	248
Deferred revenue	305	(37)
Deferred rent	714	55
Income tax payable		3
Long-term tax liabilities	33	
Net cash provided by operating activities	584	8,712
Cash flows from investing activities:		
Purchases of property and equipment	(1,357)	(246)
Restricted cash	(875)	
Net cash used in investing activities	(2,232)	(246)
Cash flows from financing activities:		
Proceeds from exercise of stock options	75	
Tax benefit from exercise of stock options	110	
Net cash provided by financing activities	185	
Effect of exchange rate changes on cash and cash equivalents	(161)	(5)
Net increase (decrease) in cash and cash equivalents	(1,624)	8,461
Cash and cash equivalents at beginning of period	22,641	33,415
Cash and cash equivalents at end of period	$ 21,017	$ 41,876
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds received	$ 5,018	$ 7,550

See accompanying notes to unaudited condensed consolidated financial statements.

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

Note 1: The Company and Basis of Presentation

Travelzoo Inc. (the Company or Travelzoo) is a global Internet media company. Travelzoo s publications and products include the *Travelzoo* Web sites (www.travelzoo.com, cn.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, the *Newsflash* e-mail alert service, the *SuperSearch* pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list travel deals published by Travelzoo.

Travelzoo is controlled by Ralph Bartel, who held beneficially approximately 56.9% of the outstanding shares as of August 5, 2008.

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 disclosure normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company, and its results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and related notes as of and for the year ended December 31, 2007, included in the Company s Form 10-K filed with the SEC on March 17, 2008.

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

The results of operations for the three months and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 or any other future period, and the Company makes no representations related thereto.

Certain prior period amounts have been reclassified to conform to current year presentation. Specifically, $219,000 and $423,000 for the three month and six month periods ending June 30, 2007, respectively, have been reclassified from cost of revenues to general and administrative expense. These amounts are primarily costs associated with salary and benefits for software developers and professional services related to software development.

The Company was formed as a result of a combination and merger of entities founded by the Company s majority stockholder, Ralph Bartel. In 1998, Mr. Bartel founded Travelzoo.com Corporation, a Bahamas corporation, which issued 5,155,874 shares via the Internet to approximately 700,000 Netsurfer stockholders for no cash consideration. In 1998, Mr. Bartel also founded Silicon Channels Corporation, a California corporation, to operate the *Travelzoo* Web site. During 2001, Travelzoo Inc. was formed as a subsidiary of Travelzoo.com Corporation, and Mr. Bartel contributed all of the outstanding shares of Silicon Channels Corporation to Travelzoo Inc. in exchange for 8,129,273 shares of Travelzoo Inc. and options to acquire an additional 2,158,349 shares at $1.00. The merger was accounted for as a combination of entities under common control using as-if pooling-of-interests accounting. Under this method of accounting, the assets and liabilities of Silicon Channels Corporation and Travelzoo Inc. were carried forward to the combined company at their historical costs. In addition, all prior period financial statements of Travelzoo Inc. were restated to include the combined results of operations, financial position and cash flows of Silicon Channels Corporation.

During January 2001, the Board of Directors of Travelzoo.com Corporation proposed that Travelzoo.com Corporation be merged with Travelzoo Inc. whereby Travelzoo Inc. would be the surviving entity. On March 15, 2002, the stockholders of Travelzoo.com Corporation approved the merger with Travelzoo Inc. On April 25, 2002, the certificate of merger was filed in Delaware upon which the merger became effective and Travelzoo.com Corporation ceased to exist. Each outstanding share of common stock of Travelzoo.com

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Corporation was converted into the right to receive one share of common stock of Travelzoo Inc. Under and subject to the terms of the merger agreement, stockholders were allowed a period of two years following the effective date of the merger to receive shares of Travelzoo Inc. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation, and no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect this reduction of the number of shares reported as outstanding. As of June 30, 2008, there were 14,285,479 shares of common stock outstanding.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,069,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of $9,000 for these cash payments for the six months ended June 30, 2008. The liability was $13,000 as of June 30, 2008, including $5,000 previously accrued as of December 31, 2007. The liability is based on the actual number of valid requests received from former stockholders through June 30, 2008 which had not yet been processed for payment. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company s common stock price. The Company s common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of

Travelzoo.com Corporation holding an additional approximately 4,069,000 shares had not submitted claims under the program as of June 30, 2008.

Note 2: Revenue Recognition

All revenue consists of advertising sales. Advertising insertions are either sold by fixed-fee arrangements or sold by variable-fee arrangements.

The Company recognizes revenues in accordance with Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. Advertising revenues are recognized in the period in which the advertisement is displayed, provided that

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evidence of an arrangement exists, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. Where collectibility is not reasonably assured, the revenue will be recognized upon cash collection, provided that the other criteria for revenue recognition have been met. The Company recognizes revenue for fixed-fee advertising arrangements ratably over the term of the insertion order as described below, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are recognized upon delivery. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed or clicks delivered during the period.

Under these policies, no revenue is recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is deemed reasonably assured. The Company evaluates each of these criteria as follows:

Evidence of an arrangement. The Company considers an insertion order signed by the client or its agency to be evidence of an arrangement.

Delivery. Delivery is considered to occur when the advertising has been displayed and, if applicable, the click-throughs have been delivered.

Fixed or determinable fee. The Company considers the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

Collection is deemed reasonably assured. The Company conducts a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if it is expected that the client will be able to pay amounts under the arrangement as payments become due. If it is determined that collection is not reasonably assured, then revenue is deferred and recognized upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

The Company s standard payment terms are 30 days net. Insertion orders that include fixed-fee advertising are invoiced upon acceptance of the insertion order and on the first day of each month over the term of the insertion order, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are primarily invoiced upon delivery. Insertion orders that include variable-fee advertising are invoiced at the end of the month. The Company s standard terms state that in the event that Travelzoo fails to publish advertisements as specified in the insertion order, the liability of Travelzoo to the client shall be limited to, at Travelzoo s sole discretion, a pro rata refund of the advertising fee, the placement of the advertisements at a later time in a comparable position, or the extension of the term of the insertion order until the advertising is fully delivered. The Company believes that no significant obligations exist after the full delivery of advertising.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

Note 3: Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS 157 became effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position (FSP) No. 157-2, which delayed the effective date of SFAS 157 one year for all non-financial assets and non-financial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. In accordance with FSP No. 157-2, the Company will measure the remaining assets and liabilities no later than the quarter ended March 31, 2009 and have not yet determined the impact of this standard on our condensed consolidated financial statements. The partial adoption of SFAS 157 for financial assets and

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liabilities did not have a material impact on our condensed consolidated financial statements in the quarter ended June 30, 2008. See Note 4 for information and related disclosures regarding the fair value of our financial assets.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. The Company adopted SFAS 159 on January 1, 2008 and did not elect to use fair value to re-measure any of its assets or liabilities.

Note 4: Financial Instruments

At June 30, 2008, restricted cash consisted of a certificate of deposit for $875,000 serving as collateral for a standby letter of credit for the security deposit of our corporate headquarters. Cash equivalents consist of highly liquid investments with remaining maturities of three months or less on the date of purchase held in money market funds. The Company believes that the carrying amounts of these financial assets are a reasonable estimate of their fair value. The fair value of these certain financial assets was determined using the following inputs at June 30, 2008 (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)
Assets				
Money market funds [(1)]	$ 14,204	$ 14,204	$	$
Total	$ 14,204	$ 14,204	$	$

(1) Included in cash and cash equivalents on our condensed consolidated balance sheet

Note 5: Internal-Use Software and Web Site Development

The Company includes in fixed assets the capitalized cost of internal-use software and Web site development, including software used to upgrade and enhance its Web site and processes supporting the Company s business in accordance with Statement of Position 98-1, Accounting for the Cost of Computer Software Developed or Obtained for Internal Use and Emerging Issues Task Force Issue No. 00-02, Accounting for Website Development Costs. Costs incurred in the planning stage and operating stage are expensed as incurred while costs incurred in the application development stage and infrastructure development stage are capitalized, assuming such costs are deemed to be recoverable.

During the three month and six month periods ended June 30, 2008, the Company capitalized internal-use software and Web site development costs totaling $515,000 and $623,000, respectively. Web site development costs relate primarily to the development of a new travel search engine. Capitalized internal-use software and Web site development costs are amortized using the straight-line method over the estimated useful life of the software or Web site.

Note 6: Stock-Based Compensation and Stock Options

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options. Stock-based compensation for awards granted prior to January 1, 2006 is based upon the grant-date fair value of such compensation as determined under the pro forma provisions of SFAS No. 123, Accounting for Stock-Based Compensation.

As described in Note 1, as part of the consideration exchanged for the outstanding shares of Silicon Channels Corporation, the Company also issued to the majority stockholder in January 2001 fully vested and exercisable options to acquire 2,158,349 shares of common stock. The options have an exercise price of $1.00 per share, are outstanding as of June 30, 2008, and expire in January 2011.

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In October 2001, the Company granted to each director fully vested and exercisable options to purchase 30,000 shares of common stock with an exercise price of $2.00 per share for their services as a director in 2000 and 2001. A total of 210,000 options were granted. The options expire in October 2011. 150,000 options were exercised during the year ended December 31, 2005, 17,275 options were exercised during the year ended December 31, 2006, and 30,000 options were exercised during the six months ended June 30, 2008. As of June 30, 2008, 12,725 of these options are vested and remain outstanding.

In March 2002, Travelzoo Inc. granted to each director options to purchase 5,000 shares of common stock with an exercise price of $3.00 per share that vested in connection with their services as a director in 2002. A total of 35,000 options were granted. The options expire in March 2012. In October 2002, 1,411 options were cancelled upon the resignation of a director. 23,589 options were exercised during the year ended December 31, 2004 and 5,000 options were exercised during the six months ended June 30, 2008. As of June 30, 2008, 5,000 of these options are vested and remain outstanding.

The Company did not record any stock-based compensation in fiscal years 2006, 2007, or in the six months ended June 30, 2008. In addition, all previously issued options vested prior to January 1, 2003.

Option activity as of June 30, 2008 and changes during the six months ended June 30, 2008 were as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2007	2,211,074	$ 1.03		
Options exercised	(35,000)	$ 2.14		
Outstanding at June 30, 2008	2,176,074	$ 1.01	2.60 years	$ 16,450
Exercisable and fully vested at June 30, 2008	2,176,074	$ 1.01	2.60 years	$ 16,450

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the second quarter of fiscal 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2008. This amount changes based on the fair market value of the Company s stock. The Company s policy is to issue shares from its authorized shares to fulfill stock option exercises.

Note 7: Net Income (Loss) Per Share

Net income (loss) per share has been calculated in accordance with SFAS No. 128, Earnings per Share. Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding for the period. Diluted net income (loss) 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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Basic net income (loss) per share:				
Net income (loss)	$ (1,193)	$ 2,846	$ (2,199)	$ 6,909
Weighted average common shares	14,269	15,250	14,260	15,250
Basic net income (loss) per share	$ (0.08)	$ 0.19	$ (0.15)	$ 0.45
Diluted net income (loss) per share:				
Net income (loss)	$ (1,193)	$ 2,846	$ (2,199)	$ 6,909
Weighted average common shares	14,269	15,250	14,260	15,250
Effect of dilutive securities: stock options		1,232		1,231
Diluted weighted average common shares	14,269	16,482	14,260	16,481
Diluted net income (loss) per share	$ (0.08)	$ 0.17	$ (0.15)	$ 0.42

Options to purchase 2,176,074 shares of common stock were outstanding as of June 30, 2008 but have been excluded from the computation of diluted net loss per share for the three months and six months ended June 30, 2008 as their effect was anti-dilutive.

Note 8: Commitments and Contingencies

The Company leases office space in Australia, Canada, China, France, Germany, Hong Kong, Japan, Spain, Taiwan, the U.K., and the U.S. under operating leases which expire between November 30, 2008 and January 31, 2014. The future minimum lease payments under these operating leases as of June 30, 2008 total $15,041,000. The future lease payments consist of $2,291,000 due in 2008, $4,202,000 due in 2009, $2,436,000 due in 2010, $1,994,000 due in 2011, $2,033,000 due in 2012 and $2,085,000 thereafter.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. If such escheat claims are asserted, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,069,000 shares of common stock for no additional payment.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert shares into Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of $9,000 for these cash payments for the six months ended June 30, 2008. The liability was $13,000 as of June 30, 2008, including $5,000 previously accrued as of December 31, 2007. The liability is based on the actual number of valid requests received from former stockholders through the reporting date which had not yet been processed for payment. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company s common stock price. The Company s common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding approximately 4,069,000 shares had not submitted claims under the program.

Note 9: Income Taxes

In determining the quarterly provisions for income taxes, the Company uses an estimated annual effective tax rate which is based on our expected annual income and statutory tax rates in the U.S. The effective tax rate does not reflect any tax benefits from the losses of our foreign operations. For the six months ended June 30, 2008, our effective tax rate was 166%.

As of June 30, 2008 and December 31, 2007, the total amount of unrecognized tax benefits was approximately $1.1 million, which if recognized, would reduce the Company s effective tax rate in the future periods.

The Company includes interest and penalties related to unrecognized tax positions in income tax expense. As of June 30, 2008 and December 31, 2007, the Company had approximately $144,000 and $111,000, respectively, in accrued interest related to uncertain tax positions. The Company has not accrued any penalties related to our uncertain tax positions as we believe that it is more likely than not that there will not be any assessment of penalties.

The Company is no longer subject to U.S. federal and certain state tax examinations for years before 2004 and is no longer subject to California tax examinations for years before 2003.

Note 10: Segment Reporting and Significant Customer Information

The Company manages its business geographically and has three reportable operating segments: North America, Europe and Asia Pacific. North America consists of the Company s operations in Canada and the U.S. Europe consists of the Company s operations in France, Germany, Spain, and the U.K. The Company began operations in Europe in May 2005. Asia Pacific consists of the Company s operations in Australia, China, Hong Kong, Japan, and Taiwan. The Company began operations in Asia Pacific in April 2007.

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 June 30, 2008:	North America	Europe	Asia Pacific	Elimination	Consolidated
Revenues from unaffiliated customers	$ 19,129	$ 2,550	$ 90	$	$ 21,769
Intersegment revenues	39	19		(58)	
Total net revenues	19,168	2,569	90	(58)	21,769
Operating income (loss)	6,929	(2,013)	(3,235)	1	1,682

Three months ended June 30, 2007:	North America	Europe	Asia Pacific	Elimination	Consolidated
Revenues from unaffiliated customers	$ 18,619	$ 1,496	$	$	$ 20,115
Intersegment revenues	77	2		(79)	
Total net revenues	18,696	1,498		(79)	20,115
Operating income (loss)	7,313	(1,161)	(400)	1	5,753

Six months ended June 30, 2008:	North America	Europe	Asia Pacific	Elimination	Consolidated

Revenues from unaffiliated customers	$ 38,019	$ 4,589	$ 110	$	$ 42,718
Intersegment revenues	64	30		(94)	
Total net revenues	38,083	4,619	110	(94)	42,718
Operating income (loss)	13,193	(4,254)	(5,979)	2	2,962

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Six months ended June 30, 2007:	North America	Europe	Asia Pacific	Elimination	Consolidated
Revenues from unaffiliated customers	$ 37,074	$ 2,781	$	$	$ 39,855
Intersegment revenues	118	5		(123)	
Total net revenues	37,192	2,786		(123)	39,855
Operating income (loss)	15,473	(1,845)	(400)	2	13,230

As of June 30, 2008	North America	Europe	Asia Pacific	Elimination	Consolidated
Property and equipment, net:	$ 1,893	$ 82	$ 181	$	$ 2,156
Total assets	56,661	4,868	2,858	(24,846)	39,541

As of December 31, 2007	North America	Europe	Asia Pacific	Elimination	Consolidated
Property and equipment, net:	$ 383	$ 70	$ 169	$	$ 622
Total assets	45,801	3,525	2,094	(14,134)	37,286

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.

Significant customer information is as follows:

	Percent of Revenues Three Months Ended June 30,		**Percent of Revenues Six Months Ended June 30,**		**Percent of Accounts Receivable**	
					June 30,	**December 31,**
Customer	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
Travelport Limited	11%	16%	11%	15%	*	14%
Expedia, Inc.	*	10%	*	11%	11%	18%

* Less than 10%

The agreements with these customers are in the form of multiple insertion orders from groups of entities under common control, in either the Company s standard form or in the customer s form.

Note 11: Comprehensive Income (Loss)

The following are components of comprehensive income (loss) (in thousands):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**
Net income (loss)	$ (1,193)	$ 2,846	$ (2,199)	$ 6,909
Other comprehensive income (loss):				
Foreign currency translation adjustments	(6)	(4)	(189)	(15)
Total comprehensive income (loss)	$ (1,199)	$ 2,842	$ (2,388)	$ 6,894

Accumulated other comprehensive loss, as reflected in the condensed consolidated balance sheets, consists of cumulative foreign currency translation adjustments.

Note 12: Foreign Currency

Realized gains and losses from foreign currency transactions are recognized as gain or loss on foreign currency. The Company does not use any derivatives for hedging or speculative purposes.

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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 , int 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 is a global Internet media company. We publish travel offers from hundreds of travel companies. As the Internet is becoming consumers preferred medium to search for travel offers, we provide airlines, hotels, cruise lines, vacation packagers, and other travel companies with a fast, flexible, and cost-effective way to reach millions of users. While our products provide advertising opportunities for travel companies, they also provide Internet users with a free source of information on current sales and specials from hundreds of travel companies.

Our publications and products include the *Travelzoo* Web sites (www.travelzoo.com, cn.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.tw, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, and the *Newsflash* e-mail alert service. We also operate *SuperSearch,* a pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party Web sites that list deals published by Travelzoo. More than 900 travel companies purchase our advertising services.

Our revenues are advertising revenues, consisting of listing fees paid primarily by travel companies to advertise their offers on the *Travelzoo* Web sites, in the *Travelzoo Top 20* e-mail newsletter, in the *Newsflash* e-mail alert service, in *SuperSearch*, and through the *Travelzoo Network*. Revenues are principally generated from the sale of advertising in the U.S. Listing fees are based on placement, number of listings, number of impressions, or number of clickthroughs. Smaller advertising agreements typically $2,000 or less per month typically renew automatically each month if they are not terminated by the client. Larger agreements are typically related to advertising campaigns and are not automatically renewed.

We have three operating segments based on geographic regions: North America, Europe and Asia Pacific. North America consists of our operations in Canada and the U.S. Europe consists of our operations in France, Germany, Spain, and the U.K. Asia Pacific consists of our operations in Australia, China, Hong Kong, Japan, and Taiwan.

When evaluating the financial condition and operating performance of the Company, management focuses on the following financial and non-financial indicators:

- Growth in the number of subscribers to the Company s newsletters and page views of the homepages of the *Travelzoo* Web sites;

- Operating margin;

- Growth in revenues in the absolute and relative to the growth in reach of the Company s publications; and

- Revenue per employee as a measure of productivity.

Critical Accounting Policies

We believe that there are a number of accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amounts of revenue and the more significant areas involving management s judgments and estimates. These significant accounting policies relate to revenue recognition, the allowance for doubtful accounts, and liabilities to former stockholders. These policies, and our procedures related to these policies, are described in detail below.

Revenue Recognition

We recognize revenue on arrangements in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition. We recognize advertising revenues in the period in which the advertisement is displayed, provided that evidence of an arrangement exists, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. If fixed-fee advertising is displayed over a term greater than one month, revenues are recognized ratably over the period as described below. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card for measuring the value of delivered and undelivered placements. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed or clicks delivered during the period.

Under these policies, no revenue is recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. The Company evaluates each of these criteria as follows:

Evidence of an arrangement. We consider an insertion order signed by the client or its agency to be evidence of an arrangement.

Delivery. Delivery is considered to occur when the advertising has been displayed and, if applicable, the clickthroughs have been delivered.

Fixed or determinable fee. We consider the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

Collection is reasonably assured. We conduct a credit review for all transactions at the time of the arrangement to determine the creditworthiness of the client. Collection is deemed reasonably assured if we expect that the client will be able to pay amounts under the arrangement as payments become due. If we determine that collection is not reasonably assured, then we defer the revenue and recognize the revenue upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

Allowance for Doubtful Accounts

We record a provision for doubtful accounts based on our historical experience of write-offs and a detailed assessment of our accounts receivable and allowance for doubtful accounts. In estimating the provision for doubtful accounts, management considers the age of the accounts receivable, our historical write-offs, the creditworthiness of the client, the economic conditions of the client s industry, and general economic conditions, among other factors. Should any of these factors change, the estimates made by management will also change, which could impact the level of our future provision for doubtful accounts. Specifically, if the financial condition of our clients were to deteriorate, affecting their ability to make payments, additional provision for doubtful accounts may be required.

Liability to Former Stockholders

On October 15, 2004, we announced a program under which we would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. We account for the cost of this program as an expense recorded in general and administrative expenses. The ultimate total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company s common stock price. The Company s common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. We do not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid. We believe that only a portion of such requests were valid. In order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation.

Since the total cost of the program is not reliably estimable, the amount of expense recorded in a period is equal to the number of actual claims received during the period multiplied by (i) the number of shares held by each individual former stockholder and (ii) the applicable settlement price based on the recent price of our common stock at the date the claim is received as stipulated by the program. Requests are generally paid within 30 days of receipt. Please refer to Note 8 to our unaudited condensed consolidated financial statements for further details about our liabilities to former stockholders.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	2.9	1.1	2.7	0.9
Gross profit	97.1	98.9	97.3	99.1
Operating expenses:				
Sales and marketing	57.5	53.4	60.7	50.3
General and administrative	31.9	16.9	29.7	15.6
Total operating expenses	89.4	70.3	90.4	65.9
Income from operations	7.7	28.6	6.9	33.2
Other income and expenses, net	0.3	2.3	0.8	2.1
Income before income taxes	8.0	30.9	7.7	35.3
Income taxes	13.5	16.8	12.9	17.9
Net income (loss)	(5.5%)	14.1%	(5.2%)	17.4%

For the three months ended June 30, 2008, we reported income from operations of approximately $1.7 million. For the six months ended June 30, 2008, we reported income from operations of approximately $3.0 million. As of June 30, 2008, we had retained earnings of approximately $23.7 million. Our income from operations decreased to 7.7% of revenues for the three months ended June 30, 2008 from 28.6% for the same period last year. Our income from operations decreased to 6.9% of revenues for the six months ended June 30, 2008 from 33.2% for the same period last year. The decrease in our income from operations is due primarily to an increase of our sales and marketing expenses and our general and administrative expenses (see Operating Expenses below). Our sales and marketing expenses and general and administrative expenses as a percentage of revenue increased at a higher rate than the rate of the increase of our revenues.

We do not know whether our sales and marketing expenses as a percentage of revenue will continue to increase in future periods. Increased competition in our industry may require us to increase advertising for our brand and for our products. Increases in the average cost of acquiring new subscribers (see Subscriber Acquisition below) may result in an increase of sales and marketing expenses as a percentage of revenue. We may decide to accelerate our subscriber acquisition for various strategic and tactical reasons and, as a result, increase our marketing expenses. We may see a unique opportunity for a brand marketing campaign that will result in an increase of marketing expenses. Further, our strategy to replicate our business model in selected foreign markets (see Growth Strategy below) may result in a significant increase in our sales and marketing expenses and have a material adverse impact on our results of operations. We expect fluctuations of sales and marketing expenses as a percentage of revenue from quarter to quarter. Some of the fluctuations may be significant and have a material impact on our results of operations.

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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. In addition, we expect our expansion into foreign markets to result in a significant additional increase in our general and administrative expenses. We expect that we will incur significant expenses in 2008 in order to allow management to report on, and our independent auditors to opine on, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002. At this time, the total cost is not reliably estimable as it will be dependent on the number of areas requiring improvement and the extent of any required remediation efforts as well as growth of our international operations. 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, and who failed to submit requests for shares in Travelzoo Inc. within the required time period.

Reach

The following table sets forth the number of subscribers of each of our e-mail publications in North America, Europe, and Asia Pacific as of June 30, 2008 and 2007 and the total number of page views for the homepages of the *Travelzoo* Web sites in North America, Europe, and Asia Pacific for the six months ended June 30, 2008 and 2007. Management considers the page views for the *Travelzoo* homepages as indicators for the growth of Web site traffic. Management reviews these non-financial metrics with the objective of monitoring the reach of our products and evaluating whether the Company is able to convert higher reach into higher revenues.

	June 30,		**Year-over-Year**
	2008	**2007**	**Growth**
Subscribers:			
North America			
Travelzoo Top 20	10,561,000	10,358,000	2%
Newsflash	8,564,000	8,222,000	4%
Europe			
Travelzoo Top 20	1,852,000	919,000	102%
Newsflash	1,745,000	851,000	105%
Asia Pacific			
Travelzoo Top 20	913,000		
Newsflash	829,000		

	Six Months Ended June 30,		**Year-over-Year**
	2008	**2007**	**Growth***
Page views of homepages of *Travelzoo* Web sites:			
North America	15,772,000	18,229,000	(13)%
Europe	3,486,000	4,565,000	(24)%
Asia Pacific	5,818,000		

* The comparability of year-over-year changes of page views of the homepages of *Travelzoo* Web sites may be

limited due to the design and navigation of the Web sites. Additionally, we believe that the increased use of security software has adversely affected the tracking of page views.

In North America, revenues for the six months ended June 30, 2008 increased by 2% from the same period last year. The total number of subscribers in North America to the Travelzoo Top 20 e-mail newsletter as of June 30, 2008 increased by 2% compared to June 30, 2007 and page views of the homepages of the Travelzoo Web sites in North America for the six months ended June 30, 2008 decreased by 13% from the same period last year. In North America, revenues increased at the same rate as the rate of growth in subscribers to the Travelzoo Top 20 e-mail newsletter.

In Europe, revenues for the six months ended June 30, 2008 increased by 66% from the same period last year. The total number of subscribers in Europe to the Travelzoo Top 20 e-mail newsletter as of June 30, 2008 increased by 102% compared to June 30, 2007 and page views of the homepages of the Travelzoo Web sites in Europe for the six months ended June 30, 2008 decreased by 24% from the same period last year. In Europe, revenues increased at a lower rate than the rate of growth in subscribers to the Travelzoo Top 20 e-mail newsletter. Management believes that the lower rate of growth in revenues was due to start up of operations in Germany, France, and Spain. In Germany, France, and Spain, we focused on rapidly building a significant subscriber base.

In the Asia Pacific, we generated $110,000 in revenue for the six months ended June 30, 2008. We did not generate any revenues in the Asia Pacific in the six months ended June 30, 2007. We began operations in Australia, China, Hong Kong, Japan, and Taiwan during 2007 and have focused on rapidly building a significant subscriber base in the countries in which we operate.

Revenues

Our total revenues increased to $21.8 million for the three months ended June 30, 2008 from $20.1 million for the three months ended June 30, 2007. This represents an increase of 8%. Our total revenues increased to $42.7 million for the six months ended June 30, 2008 from $39.9 million for the six months ended June 30, 2007. This represents an increase of 7%.

64% of our revenue growth in the three months ended June 30, 2008 compared to the three months ended June 30, 2007 came from increased revenues from our operations in Europe. 31% of our revenue growth came from our operations in North America (i.e. *Travelzoo* Web sites, *Travelzoo Top 20* newsletter, *Newsflash*, *SuperSearch* and *Travelzoo Network*) and is attributed to an increase in the number of clients in North America, an increase in the volume of advertising sold to existing clients in North America, and from new product offerings in North America. The remaining 5% of our revenue growth came from our operations in Asia Pacific which did not generate any revenues in the three months ended June 30, 2007.

63% of our revenue growth in the six months ended June 30, 2008 compared to the six months ended June 30, 2007 came from increased revenues from our operations in Europe. 33% of our revenue growth came from our operations in North America (i.e. *Travelzoo* Web sites, *Travelzoo Top 20* newsletter, *Newsflash*, *SuperSearch* and *Travelzoo Network*) and is attributed to an increase in the number of clients in North America, an increase in the volume of advertising sold to existing clients in North America, and from new product offerings in North America. The remaining 4% of our revenue growth came from our operations in Asia Pacific which did not generate any revenues in the six months ended June 30, 2007.

As discussed in Note 10 in the notes to the condensed consolidated financial statements, one client accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2008. Two clients each accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2007. No other clients accounted for 10% or more of our total revenues during the three months and six months ended June 30, 2008 and 2007. The agreements with these clients are in the form of multiple insertion orders from groups of entities under common control. Management expects revenue concentration to remain at the current level in the foreseeable future because there is a high concentration in the online travel agency industry.

Management believes that our ability to increase revenues in the future depends mainly on the following factors:

- Our ability to increase our advertising rates;
- Our ability to sell more advertising to existing clients;
- Our ability to increase the number of clients;
- Our ability to develop new revenue streams; and
- Our ability to launch new products.

We believe that we can increase our advertising rates if the reach of our publications increases. We do not know if we will be able to increase the reach of our publications. 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 online advertising continues to grow. We do not know if we will be able to maintain or increase our market share. We historically have increased the number of clients in every year since inception. We do not know if we will be able to increase the number of clients in the future. We do not know if we will have market acceptance of our new products.

Historically, we have increased advertising rates as of January 1 of each year. However, we did not increase our advertising rates in the U.S. on January 1, 2008 due to intense price competition in our industry. We intend to review advertising rates and consider increases once a year as of January 1. However, there is no assurance that there will be increases of advertising rates. Depending on the level of competition in the industry and the condition of the online advertising market, we may decide not to increase our advertising rates.

Average annualized revenue per employee decreased to $456,000 for the three months ended June 30, 2008 from $712,000 for the three months ended June 30, 2007. The decrease in average revenue per employee for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to an increase in headcount related to the start-up of our business in Europe and Asia Pacific.

Cost of Revenues

Cost of revenues consists of network expenses, including fees we pay for co-location services, depreciation of network equipment, payments made to affiliate partners of the *Travelzoo Network*, and salary expenses associated with network operations staff. Our cost of revenues increased to $637,000 for the three months ended June 30, 2008 from $225,000 for the three months ended June 30, 2007. Our cost of revenues increased to $1.2 million for the six months ended June 30, 2008 from $374,000 for the six months ended June 30, 2007. As a percentage of revenue, cost of revenues increased to 3% for the three months and six months ended June 30, 2008 from 1% for the three months and six months ended June 30, 2007. The $412,000 increase in cost of revenues for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a $272,000 increase in payments made to affiliate partners of the *Travelzoo Network*. The $792,000 increase in cost of revenues for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to a $509,000 increase in payments made to affiliate 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 and marketing staff, expenses related to our participation in industry conferences, and public relations expenses. Sales and marketing expenses increased to $12.5 million for the three months ended June 30, 2008 from $10.7 million for the three months ended June 30, 2007. Sales and marketing expenses increased to $25.9 million for the six months ended June 30, 2008 from $20.1 million for the six months ended June 30, 2007. The goal of our advertising was to acquire new subscribers for our e-mail products, increase the traffic to our Web sites, and increase brand awareness for *Travelzoo*. The $1.8 million increase in sales and marketing expenses for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a $945,000 increase in advertising to acquire new subscribers for our e-mail products and a $1.4 million increase in salary and employee related expenses due primarily to an increase in the headcount of our sales and marketing staff offset by a $354,000 decrease in advertising to acquire traffic to our Web site. For the three months ended June 30, 2008 and 2007, advertising expenses accounted for 59% and 68%, respectively, of total sales and marketing expenses. The $5.9 million increase in sales and marketing expenses for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to a $2.6 million increase in salary and employee related expenses due primarily to an increase in the headcount of our sales and marketing staff, a $2.5 million increase in advertising to acquire new subscribers for our e-mail products, and a $463,000 increase in advertising to acquire traffic to our Web sites. For the six months ended June 30, 2008 and 2007, advertising expenses accounted for 63% and 68% of total sales and marketing expenses, respectively.

Our goal is to increase our revenues from advertising sales. One important factor that drives our revenues is our advertising rates. We believe that we can increase our advertising rates if the reach of our publications increases. In order to increase the reach of our publications, we have to acquire a significant number of new subscribers 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 subscriber. 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 subscriber acquisition efforts successfully, and the degree of competition in our industry.

In May 2005, we began operations in the U.K. In 2006, we began operations in Canada, Germany, and Spain. In 2007, we began operations in Australia, China, France, Hong Kong, Japan, and Taiwan. The start-up of our business in Europe and Asia Pacific and our plan to expand into other countries in the future is expected to result in a significant increase in our sales and marketing expenses in the foreseeable future.

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General and Administrative

General and administrative expenses consist primarily of compensation for administrative, executive, and software development staff, fees for professional services, rent, bad debt expense, amortization of intangible assets, and general office expense. General and administrative expenses increased to $6.9 million for the three months ended June 30, 2008 from $3.4 million for the three months ended June 30, 2007. General and administrative expenses increased to $12.7 million for the six months ended June 30, 2008 from $6.2 million for the six months ended June 30, 2007. The $3.5 million increase in general and administrative expenses for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to a $2.0 million increase in salary and employee related expenses due primarily to an increase in headcount, a $762,000 increase in rent and office expense, and a $683,000 increase in professional services expenses. The $6.5 million increase in general and administrative expenses for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to an $3.6 million increase in salary and employee related expenses due primarily to an increase in headcount, a $1.5 million increase in rent and office expense, and a $960,000 increase in professional services expenses.

In the six months ended June 30, 2008 and 2007, the Company recorded expenses of $9,000 and $72,000, respectively, related to a program under which the Company makes cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests for shares in Travelzoo Inc. within the required time period. The expenses are based on the number of actual valid claims received and the Company s stock price. The Company cannot reliably estimate future expenses incurred under this program because it is based on the number of valid requests received and future levels of the Company s common stock price.

We expect our headcount to increase in the future. The Company s headcount is one of the main drivers of general and administrative expenses. Therefore, we expect our general and administrative expenses to continue to increase.

Our strategy to replicate our business model in foreign markets is expected to result in a significant additional increase in our general and administrative expenses in the foreseeable future.

Subscriber Acquisition

The table set forth below provides for each quarter in 2005, 2006, 2007 and the first six months of 2008, an analysis of our average cost for acquisition of new subscribers for our *Travelzoo Top 20* newsletter and our *Newsflash* e-mail alert service for our North America, Europe and Asia Pacific operating segments.

The table includes the following data:

Average Cost per Acquisition of a New Subscriber: This is the quarterly cost of consumer marketing programs whose purpose was primarily to acquire new subscribers, divided by total new subscribers added during the quarter.

New Subscribers: Total new subscribers who signed up for at least one of our e-mail publications throughout the quarter. This is an unduplicated subscriber number, meaning a subscriber who signed up for two or more of our publications is only counted once.

Subscribers Removed From List: Subscribers who were removed from our lists throughout the quarter either as a result of their requesting removal, or based on periodic list maintenance after we determined that the e-mail address was likely no longer valid.

Balance: This is the number of subscribers at the end of the quarter, computed by taking the previous quarter s subscriber balance, adding new subscribers during the current quarter, and subtracting unsubscribes during the current quarter.

North America:

Period	Average Cost per Acquisition of a New Subscriber	New Subscribers	Subscribers Removed From List	Balance
Q1 2005	$ 2.59	659,459	(475,938)	8,329,258
Q2 2005	$ 2.62	806,734	(533,109)	8,602,883
Q3 2005	$ 3.19	740,768	(422,868)	8,920,783
Q4 2005	$ 2.41	729,460	(273,389)	9,376,854
Q1 2006	$ 2.54	714,643	(317,947)	9,773,550
Q2 2006	$ 2.11	737,735	(532,676)	9,978,609
Q3 2006	$ 1.86	491,524	(327,471)	10,142,662
Q4 2006	$ 1.56	373,559	(288,883)	10,227,338
Q1 2007	$ 2.61	730,063	(345,896)	10,611,505
Q2 2007	$ 3.03	552,488	(335,304)	10,828,689
Q3 2007	$ 3.92	385,408	(255,008)	10,959,089
Q4 2007	$ 3.78	279,967	(242,822)	10,996,234
Q1 2008	$ 4.97	296,565	(270,427)	11,022,372
Q2 2008	$ 3.39	348,506	(303,623)	11,067,255

Europe:

Period	Average Cost per Acquisition of a New Subscriber	New Subscribers	Subscribers Removed From List	Balance
Q3 2005	$ 1.65	127,857	(5,577)	140,153
Q4 2005	$ 2.02	174,514	(16,898)	297,769
Q1 2006	$ 2.15	143,666	(16,831)	424,604
Q2 2006	$ 2.69	129,438	(34,070)	519,972
Q3 2006	$ 1.23	126,566	(29,794)	616,744
Q4 2006	$ 2.94	69,489	(30,943)	655,290
Q1 2007	$ 3.89	159,439	(31,350)	783,379
Q2 2007	$ 4.43	206,003	(39,690)	949,692
Q3 2007	$ 2.96	331,903	(32,689)	1,248,906
Q4 2007	$ 5.85	165,781	(33,357)	1,381,330
Q1 2008	$ 3.90	362,417	(45,152)	1,698,595
Q2 2008	$ 4.89	226,156	(31,055)	1,893,696

Asia Pacific:

Average Cost per Acquisition of a	Subscribers