PRICELINE COM INC
Form 10-Q
May 10, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended March 31, 2005
	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 Number 0-25581

PRICELINE.COM INCORPORATED

(Exact name of Registrant as specified in its charter)

Delaware	**06-1528493**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

800 Connecticut Avenue

Norwalk, Connecticut 06854

(address of principal executive offices)

(203) 299-8000

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed, since last report)

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 ý. NO o.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act. YES ý. NO o.

Number of shares of Common Stock outstanding at May 3, 2005:

Common Stock, par value $0.008 per share	**39,250,114**
(Class)	(Number of Shares)

priceline.com Incorporated

Form 10-Q

For the Quarter Ended March 31, 2005

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Condensed Financial Statements

priceline.com Incorporated

CONSOLIDATED BALANCE SHEETS

(unaudited)

(In thousands, except share data)

	March 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 100,071	$ 101,270
Restricted cash	23,855	23,572
Short-term investments	141,967	122,812
Accounts receivable, net of allowance for doubtful accounts of $1,211 and $1,390, respectively	25,915	18,314
Prepaid expenses and other current assets	6,419	6,578
Total current assets	298,227	272,546
Property and equipment, net	17,672	15,827
Intangible assets, net	94,195	98,908
Goodwill	132,540	138,859
Other assets	17,164	15,942
Total assets	$ 559,798	$ 542,082
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 58,900	$ 40,612
Accrued expenses	19,620	23,649
Deferred merchant bookings	7,950	5,641
Other current liabilities	4,047	4,475
Total current liabilities	90,517	74,377
Deferred taxes	22,624	25,668
Other long-term liabilities	1,573	692
Minority interest	4,459	4,314
Long-term debt	223,576	224,418
Total liabilities	342,749	329,469
Commitments and Contingencies (See Note 16)		
Series B mandatorily redeemable preferred stock, $0.01 par value per share; 80,000 authorized shares; $1,000 liquidation value per share; 80,000 shares issued; 13,470 and 13,470 shares outstanding, respectively	13,470	13,470
Stockholders equity:		
Common stock, $0.008 par value per share, authorized 1,000,000,000 shares, issued 41,737,559, and 41,356,576 shares, respectively	319	317
Treasury stock, 2,496,326 shares	(350,628)	(350,628)
Additional paid-in capital	2,071,625	2,064,224
Deferred compensation	(6,146)	(1,264)
Accumulated deficit	(1,521,333)	(1,525,447)
Accumulated other comprehensive income	9,742	11,941
Total stockholders equity	203,579	199,143
Total liabilities and stockholders equity	$ 559,798	$ 542,082

See Notes to Unaudited Consolidated Financial Statements.

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priceline.com Incorporated

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(In thousands, except per share data)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Merchant revenues	$ 217,528	$ 217,011
Agency revenues	14,925	6,448
Other revenues	939	672
Total revenues	233,392	224,131
Cost of merchant revenues	175,685	180,757
Cost of agency revenues		
Cost of other revenues		
Total costs of revenues	175,685	180,757
Gross profit	57,707	43,374
Operating expenses:		
Advertising Offline	11,072	10,664
Advertising Online	9,932	4,741
Sales and marketing	8,208	6,706
Personnel, including stock based compensation of $714 and $106, respectively	11,222	8,341
General and administrative, including option payroll taxes of $18 and $40, respectively	4,237	3,509
Information technology	2,739	2,514
Depreciation and amortization	5,466	2,220
Restructuring reversal	(336)	
Total operating expenses	$ 52,540	$ 38,695
Operating income	5,167	4,679
Other income:		
Interest income	1,456	1,110
Interest expense	(1,293)	(566)
Other	(654)	6
Total other income (loss)	(491)	550
Earnings before income taxes and equity in income (loss) of investees	4,676	5,229
Income tax benefit	290	
Equity in income (loss) of investees, net	26	(126)
Net income	4,992	5,103
Preferred stock dividend	(878)	(772)
Net income applicable to common stockholders	$ 4,114	$ 4,331
Net income applicable to common stockholders per basic common share	$ 0.11	$ 0.12
Weighted average number of basic common shares outstanding	38,863	37,588
Net income applicable to common stockholders per diluted common share	$ 0.10	$ 0.11
Weighted average number of diluted common shares outstanding	39,764	38,905

See Notes to Unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE THREE MONTHS ENDED MARCH 31, 2005

(unaudited)

(In thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock Shares	Treasury Stock Amount	Deferred Compensation	Total
Balance, January 1, 2005	41,357	$ 317	$ 2,064,224	$ (1,525,447)	$ 11,941	(2,496)	$ (350,628)	$ (1,264)	$ 199,143
Net income applicable to common stockholders				4,114					4,114
Unrealized loss on marketable securities					(33)				(33)
Currency translation adjustment					(2,166)				(2,166)
Comprehensive income									1,915
Issuance of stock under compensation plans	240	2	5,380					(5,382)	
Amortization of deferred compensation								500	500
Issuance of preferred stock dividend	40		878						878
Exercise of stock options and warrants	100		1,143						1,143
Balance, March 31, 2005	41,737	$ 319	$ 2,071,625	$ (1,521,333)	$ 9,742	(2,496)	$ (350,628)	$ (6,146)	$ 203,579

See Notes to Unaudited Consolidated Financial Statements.

priceline.com Incorporated

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(In thousands)

	Three Months Ended March 31, 2005		Three Months Ended March 31, 2004	
OPERATING ACTIVITIES:				
Net income	$	4,992	$	5,103
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		2,289		2,078
Amortization		3,516		142
Provision for uncollectible accounts, net		551		25
Deferred income taxes		(745)		
Net gain on disposal of property and equipment				(6)
Equity in (income) loss of investees, net		(26)		126
Compensation expense arising from restricted stock awards		714		106
Amortization of debt issuance costs		364		216
Changes in assets and liabilities:				
Accounts receivable		(8,259)		(8,295)
Prepaid expenses and other current assets		207		1,343
Accounts payable and accrued expenses		20,045		9,492
Other		(955)		336
Net cash provided by operating activities		22,693		10,666
INVESTING ACTIVITIES:				
Acquisitions and other equity investments, net of cash acquired		(1,000)		
(Investment in) redemption of short-term investments, net		(19,188)		72,160
Additions to property and equipment		(4,142)		(1,247)
Proceeds from sales of fixed assets				7
Change in restricted cash		(288)		101
Net cash provided by/(used in) investing activities		(24,618)		71,021
FINANCING ACTIVITIES:				
Debt issuance costs				(51)
Proceeds from exercise of stock options and warrants		1,143		564
Net cash provided by financing activities		1,143		513
Effect of exchange rate changes on cash and cash equivalents		(417)		160
Net increase/(decrease) in cash and cash equivalents		(1,199)		82,360
Cash and cash equivalents, beginning of period		101,270		93,732
Cash and cash equivalents, end of period	$	100,071	$	176,092
SUPPLEMENTAL CASH FLOW INFORMATION:				
Cash paid during the period for income taxes	$	150	$	
Cash paid during period for interest	$	1,877	$	39

See Notes to Unaudited Consolidated Financial Statements.

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Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

Priceline.com Incorporated (priceline.com or the Company) is responsible for the consolidated condensed financial statements included in this document. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include all normal and recurring adjustments that management of the Company considers necessary for a fair presentation of its financial position and operating results. The Company prepared the consolidated financial statements following the requirements of the Securities and Exchange Commission for interim reporting. As permitted under those rules, the Company condensed or omitted certain footnotes or other financial information that are normally required by GAAP for annual financial statements. These statements should be read in combination with the consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, priceline.com Europe Holdings N. V. and Travelweb LLC (Travelweb), and its majority-owned subsidiary, Active Hotels Ltd. (Active Hotels). All significant intercompany accounts and transactions have been eliminated in consolidation. Investments in affiliates in which the Company does not have control, but has the ability to exercise significant influence, are accounted for by the equity method.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. Certain reclassifications have been made to the prior year financial information to conform to the current year presentation.

2. BUSINESS ACQUISITIONS

In September 2004, Priceline.com Holdco U.K. Limited, a newly formed English wholly-owned subsidiary of priceline.com, entered into a Sale and Purchase Agreement with shareholders and option holders of Active Hotels, one of Europe s leading online reservation providers to the hotel industry for the acquisition of approximately 97% of the equity interest in Active Hotels.

In May 2004, Lowestfare.com, a wholly-owned subsidiary of the Company, acquired 71.4% of the equity interest in Travelweb, a Delaware limited liability company owned by Marriott International, Inc. (Marriott), Hilton Hotels Corporation (Hilton), Hyatt Corporation (Hyatt), Starwood Hotels & Resorts Worldwide, Inc. (Starwood), InterContinental Hotels Group (InterContinental) and Pegasus Solutions, Inc. (Pegusus), or their affiliates. Travelweb is a full-service, automated hotel distribution network founded by Marriott, Hilton, Hyatt, Starwood, Pegasus and InterContinental. The equity interests acquired were all but those held by InterContinental. The Company acquired the InterContinental interests in December 2004, bringing the Company s total ownership of Travelweb to 100%.

In connection with the acquisition of Travelweb, the Company agreed to pay additional purchase price consideration of approximately 954,547 shares of its common stock in the event certain performance goals were met during the first 12-month period after acquisition. The 12-month period was completed in May 2005 and the performance goals were not met.

The Company expects to incur costs of approximately $2.5 million for severance and contract terminations related to the Travelweb acquisition. The Company has identified and notified the affected Travelweb personnel and vendors. Such exiting costs are expected to be paid out in cash and approximately $1.5 million was paid as of March 31, 2005.

The acquisitions of Active Hotels and Travelweb have been accounted for under the purchase method of accounting. The Company s consolidated condensed financial statements and results of operations include the accounts of Active Hotels since September 21, 2004 and Travelweb since May 1, 2004. Prior to the May 2004 acquisition, the Company accounted for its investment in Travelweb under the equity method of accounting.

The following unaudited pro forma financial information presents the combined results of operations of the Company as if the acquisitions of Travelweb and Active Hotels had occurred as of January 1, 2004. These statements include certain purchase related entries and are not necessarily indicative of the actual results of operations that might have occurred, nor are they necessarily indicative of expected results in the future.

(in thousands, except per common share amounts)		Three Months Ended March 31, 2004
Proforma revenues	$	233,441
Proforma net loss applicable to common stockholders	$	(573)
Proforma per share amounts:		
Net loss applicable to common stockholders per basic common share	$	(0.02)
Net loss applicable to common stockholders per diluted common share	$	(0.01)

3. STOCK-BASED EMPLOYEE COMPENSATION

The following table summarizes relevant information as to reported results under the Company s APB Opinion No. 25 method of accounting for stock options with supplemental information as if the fair value recognition provisions of SFAS No. 123 had been applied (in thousands, except per share amounts):

	For the Three Months Ended March 31,			
		2005		2004
Net income applicable to common stockholders, as reported	$	4,114	$	4,331
Add: Stock-based compensation, as reported		714		106
Deduct: Total stock-based compensation determined under SFAS 123 fair value based method for all stock-based compensation		(2,467)		(2,324)
Adjusted net income, SFAS 123, fair value method for all stock-based compensation	$	2,361	$	2,113
Net income applicable to common stockholders per basic common share, as reported	$	0.11	$	0.12
Net income applicable to common stockholders per diluted common share, as reported		0.10		0.11
Basic income per share SFAS 123 adjusted		0.06		0.06
Diluted income per share SFAS 123 adjusted	$	0.06	$	0.05

The fair value of stock options granted was determined on the date of grant using the Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	2005	2004
Risk-free interest rate	3.9%	2.8%
Expected lives	3 years	3 years
Volatility	79%	95%

In connection with its acquisition of Active Hotels the Company granted restricted stock in Active Hotels to certain employees of Active Hotels. An accrual for deferred compensation expense related to the granted restricted stock of approximately $2.1 million was recorded at the time of issuance as deferred compensation, and will be amortized over the three-year vesting period.

In February 2005, the Company issued an aggregate of 247,800 shares of restricted common stock to its employees and a director. The restricted stock has vesting periods of 13 months to 49 months. The accrual for deferred compensation expense related to the shares issued totaled $5.5 million and was recorded at the market value on the date of the grant as deferred compensation and the related compensation expense is being amortized over the vesting period.

During the three months ended March 31, 2005 and 2004, the Company recorded stock-based compensation expense amortization of $714,000 and $106,000, respectively.

4. NET INCOME PER SHARE

The Company computes both basic and diluted earnings per share in accordance with SFAS No. 128, Earnings per Share. Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is based upon the weighted average number of common and common equivalent shares outstanding during the year which is calculated using the treasury stock method for stock options, warrants and restricted stock. Stock options and warrants for which the exercise price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the calculation. Also excluded from the calculation of diluted EPS are the shares that would be issued upon the conversion of the Company s 1% and 2.25% Notes (See Note 10 to the consolidated financial statements) because their inclusion would have an anti-dilutive effect on EPS.

A reconciliation of net income and the weighted average number of shares outstanding used in calculating diluted earnings per share is as follows (in thousands):

	For the Three Months Ended March 31, 2005		For the Three Months Ended March 31, 2004	
Net income applicable to common stockholders	$	4,114	$	4,331
Weighted average number of basic common shares outstanding		38,863		37,588
Weighted average dilutive stock options, warrants and restricted stock		901		1,317
Weighted average number of diluted common shares outstanding		39,764		38,905
Anti-dilutive potential common shares		14,151		8,855

5. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2004, the Emerging Issues Task Force (EITF) issued statement EITF Issue No. 04-08, The Effect of Contingently Convertible Debt on Diluted Earnings per Share (EITF 04-08). Contingently convertible debt instruments are generally convertible into common shares of an issuer after the common stock price has exceeded a predetermined threshold for a specified period of time (the market price contingency). EITF 04-08 requires that shares issuable upon conversion of contingently convertible debt, such as the Company s 2.25% Convertible Senior Notes due January 15, 2025 (the 2.25% Notes) and its 1.00% Convertible Senior Notes due August 1, 2010 (the 1% Notes and, together with the 2.25% Notes, the Notes), be included in diluted earnings per share computations regardless of whether the market price contingency contained in the debt instrument has been met. The Company has historically excluded the potential dilutive effect of the conversion feature from its calculation of diluted earnings per share. EITF 04-08 became effective for reporting periods ending after December 15, 2004 and required restatement of prior periods to the extent applicable. The adoption of EITF 04-08 required the Company to include approximately 3,125,000 and 2,635,046 additional shares, respectively, of common stock underlying the 1% Notes and 2.25% Notes in its diluted earnings per share calculation in the event that their inclusion is dilutive to earnings per share. The impact of the additional shares in the calculation of diluted earnings per share is offset by exclusion of coupon interest and amortization of debt issuance costs associated with the Notes. Although the adoption of EITF 04-08 did not impact the calculation of our diluted earnings per share in either the first quarter of 2005 or 2004, because they were anti-dilutive, their inclusion could result in a material reduction in our diluted earnings per share in future periods.

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004) (SFAS 123 (R)), Share-Based Payment , which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) eliminates the ability to account for share-based compensation transactions using Accounting Principles Board Opinion No. 25 and requires that such transactions be accounted for using a fair value-based method. SFAS 123 (R) covers a wide range of share-based compensation arrangements including stock options and restricted share plans. The Company will be required to apply SFAS 123 (R) as of January 1, 2006.

The Company expects to adopt SFAS 123(R) using the "modified prospective" method in which compensation cost is recognized beginning with the effective date based on (a) the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) the requirements of Statement 123(R) for all awards granted to employees prior to the effective date of SFAS 123 (R) that remain unvested on the effective date. Upon adoption of SFAS 123(R), the impact of unvested stock options granted as of March 31, 2005 is estimated to increase personnel expense by $5.8 million in 2006 and $2.0 million in 2007.

6. RESTRUCTURING

At March 31, 2005 the restructuring liability consisted of estimated remaining real estate costs related to leased property vacated in connection with the Company s 2000 restructuring. During the three months ended March 31, 2005, the Company decreased the liability for the restructuring charge by $336,000 based upon a re-evaluation of estimated costs to complete certain restructuring activities. A roll forward of the Company s restructuring obligation is as follows (in thousands):

Accrued at January 1, 2005	$	870
Disbursed during 2005		(133)
Reversal of restructuring liability		(336)
Currency translation adjustment		(2)
Accrued at March 31, 2005	$	399

The Company estimates, based on current available information, the remaining net cash outflows associated with its restructuring related commitments will be paid in 2005. The restructuring accrual is recorded in Accrued expenses on the Company s Consolidated Balance Sheets.

7. SHORT-TERM INVESTMENTS

The following table summarizes, by major security type, the Company s marketable securities as of March 31, 2005 (in thousands):

		Amortized Cost		Gross Unrealized Loss		Estimated Fair Value
Commercial Paper	$	22,265	$	(23)	$	22,242
Corporate Notes		16,588		(42)		16,546
United States Government Agencies		66,004		(401)		65,603
USGA - Discount Notes		30,471		(25)		30,446
Medium Term Corporate Notes		7,184		(54)		7,130
	$	142,512	$	(545)	$	141,967

Contractual maturities of marketable securities classified as available-for-sale as of March 31, 2005 are as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$ 60,913	$ 60,835
Due between one year and two years	81,599	81,132
Totals	$ 142,512	$ 141,967

No material gains or losses were realized for the three months ended March 31, 2005 or 2004.

8. INTANGIBLE ASSETS

The Company s intangible assets consist of the following (in thousands):

	March 31, 2005			December 31, 2004				Weighted
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Amortization Period	Average Useful Life
Intangible assets with determinable lives:								
Supply and distribution agreements	$ 78,346	$ (5,042)	$ 73,304	$ 79,397	$ (3,017)	$ 76,380	1-13 years	12 years
Technology	9,034	(1,936)	7,098	9,145	(1,193)	7,952	1-3 years	3 years
Patents	1,494	(975)	519	1,435	(960)	475	3-15 years	3 years
Customer lists	5,388	(1,761)	3,627	5,437	(1,074)	4,363	1-3 years	2 years
Other	303	(206)	97	359	(203)	156	1-15 years	9 years
Subtotal	94,565	(9,920)	84,645	95,773	(6,447)	89,326		
Intangible assets with indefinite lives:								
Internet domain names	6,602		6,602	6,592		6,592		
Tradenames	2,948		2,948	2,990		2,990		
Subtotal	9,550		9,550	9,582		9,582		
Total intangible assets	$ 104,115	$ (9,920)	$ 94,195	$ 105,355	$ (6,447)	$ 98,908		

Intangible assets with determinable lives are primarily amortized on a straight-line basis. Intangible assets amortization expense was approximately $3.5 million and $142,000 for the three months ended March 31, 2005 and 2004, respectively.

The estimated amortization expense for the amortizable acquired intangible assets for the remainder of 2005 and years thereafter is expected to be as follows (in thousands):

2005	$ 10,220
2006	11,701
2007	7,725
2008	5,660
2009	5,660
Thereafter	43,679
	$ 84,645

9. OTHER ASSETS

Other assets at March 31, 2005 and December 31, 2004 consist of the following (in thousands):

	March 31, 2005	December 31, 2004
Investment in pricelinemortgage.com	$ 9,455	$ 9,429
Deferred debt issuance costs	5,766	6,130
Other	1,943	383
Total	$ 17,164	$ 15,942

Deferred debt issuance costs arose from the Company s issuance of $125 million aggregate principal amount of 1% Convertible Senior Notes due August 1, 2010 and the issuance of $100 million aggregate principal amount of 2.25% Convertible Senior Notes due January 15, 2025. Deferred debt issuance costs of approximately $4.3 million and $3.3 million, respectively, consisting primarily of underwriting commissions and professional service fees, are being amortized using the effective interest rate method over approximately five year periods.

10. CONVERTIBLE DEBT

In August 2003, the Company issued, in a private placement, $125 million aggregate principal amount of Convertible Senior Notes due August 1, 2010, with an interest rate of 1%. The 1% Notes are convertible, subject to certain conditions, into priceline.com s common stock, par value $0.008 per share, at the option of the holder, at a conversion price of approximately $40.00 per share, subject to adjustment upon the occurrence of specified events. Each $1,000 principal amount of 1% Notes will initially be convertible into 25 shares of the Company s common stock if, on or prior to August 1, 2008, the closing price of the Company s common stock for at least 20 trading days in the 30 consecutive trading days ending on the first day of a conversion period is more than 110% of the then current conversion price of the 1% Notes, or after August 1, 2008, if the closing price of the Company s common stock is more than 110% of the then current conversion price of the 1% Notes. The 1% Notes are also convertible in certain other circumstances, such as a change in control of the Company. In addition, the 1% Notes will be redeemable at the Company s option beginning in 2008, and the holders may require the Company to repurchase the 1% Notes on August 1, 2008 or in certain other circumstances. Interest on the 1% Notes is payable on February 1 and August 1 of each year.

In November 2003, the Company entered into an interest rate swap agreement whereby it swapped the fixed 1% interest on its 1% Notes for a floating interest rate based on the 3-month U.S. Dollar LIBOR, minus the applicable margin of 221 basis points, on $45 million notional value of debt. This agreement expires August 1, 2010. The Company designated this interest rate swap agreement as a fair value hedge. The changes in the fair value of the interest rate swap agreement and the underlying debt are recorded as offsetting gains and losses in interest income and expense in the consolidated statement of operations. Hedge ineffectiveness of $15,000 was recorded as a reduction of interest income for the three months ended March 31, 2005. Hedge ineffectiveness of $57,000 was recorded as interest income for the three months ended March 31, 2004. The fair value (cost if terminated) of this swap as of March 31, 2005 was approximately $1.6 million and has been recorded as a credit in other long-term liabilities with a related adjustment to the carrying value of debt.

In June 2004, the Company issued, in a private placement, $100 million aggregate principal amount of Convertible Senior Notes due January 15, 2025, with an interest rate of 2.25%. The 2.25% Notes are convertible, subject to certain conditions, into priceline.com s common stock, par value $0.008 per share, at the option of the holder, at a conversion price of approximately $37.95 per share, subject to adjustment upon the occurrence of specified events. Each $1,000 principal amount of 2.25% Notes will initially be convertible into 26.3505 shares of the Company s common stock if, on or prior to January 15, 2025, certain conditions occur. The 2.25% Notes are also convertible in certain other circumstances, such as a change in control of the Company. In the event that all or substantially all of the Company s common stock is acquired prior to January 15, 2010, in a transaction in which the consideration paid to holders of the Company s common stock consists of all or substantially all cash, the Company would be required to make additional payments to the holders of the 2.25% Notes of amounts ranging from $0 to $19.1 million depending upon the date of the transaction and the then current stock price of the Company. The Company s obligation to make this payment is treated as an embedded derivative which, pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), must be assigned its own value separate and apart from the value of the 2.25% Notes. The estimated value of the derivative has been established based upon several quantitative and qualitative factors and will be amortized as interest expense ratably over approximately a 5 ½ year period. Pursuant to SFAS 133, any subsequent changes in the value of the derivative will be recognized as income or expense in the period in which the change in value occurs. In addition, the 2.25% Notes will be redeemable at the Company s option beginning January 20, 2010, and the holders may require the Company to repurchase the 2.25% Notes on January 15, 2010, 2015 and 2020, or in certain other circumstances. Interest on the 2.25% Notes is payable on January 15 and July 15 of each year.

During 2004, the Company used a portion of the net proceeds from the issuance of the 1% Notes and the 2.25% Notes in the acquisitions of Travelweb and Active Hotels. The remaining proceeds are available for general corporate purposes, strategic uses and working capital requirements.

11. TREASURY STOCK

On July 31, 2002, the Company s Board of Directors authorized the repurchase of up to $40 million of the Company s common stock from time to time in the open market or in privately negotiated transactions. As part of the stock repurchase program, the Company purchased 897,953 shares of its common stock for its treasury during the period ended December 31, 2002 at an aggregate cost of approximately $11.8 million and purchased an additional 690,000 shares of its common stock for its treasury during the year ended December 31, 2003 at an aggregate cost of approximately $12.2 million. All shares were purchased at prevailing market prices. The Company did not repurchase any shares during the three months ended March 31, 2005.

The Company may continue or, from time to time, commence or suspend repurchases of shares under its stock repurchase program, depending on prevailing market conditions, alternate uses of capital and other factors. Whether and when to initiate and/or complete any purchase of common stock and the amount of common stock purchased will be determined in the Company s complete discretion.

As of March 31, 2005, there were approximately 2.5 million shares of the Company s common stock held in treasury.

12. REDEEMABLE PREFERRED STOCK

In February 2005 and 2004, the Company issued Delta Air Lines, Inc. a dividend on the Series B Redeemable Preferred Stock in the amount of 40,240 shares of the Company s common stock. As a result, the Company recorded a non-cash dividend charge of $878,000 and $772,000 in the first quarter of 2005 and 2004, respectively.

13. GOODWILL

A substantial majority of the Company s goodwill relates to its acquisitions of Active Hotels and Travelweb.

Goodwill at March 31, 2005 consists of the following (in thousands):

Balance, beginning of year	$	138,859
Deferred tax adjustment related to acquisition of Active Hotels		(4,849)
Adjustment of pre-acquisition liability related to Travelweb acquisition		(16)
Currency translation adjustments		(1,454)
Balance at March 31, 2005	$	132,540

During the three months ended March 31, 2005, goodwill and deferred taxes were reduced by approximately $4.8 million as a result of a purchase price allocation adjustment related to the assignment of fair values to the acquired assets and liabilities of Active Hotels.

14. OTHER WARRANTS TO PURCHASE COMMON STOCK

In November 1999, the Company entered into separate Participation Warrant Agreements with certain domestic airlines relating to their inclusion in the Company s leisure airline ticket service. Under the Participation Warrant Agreements, the airlines were granted warrants to purchase a total of approximately 2.2 million shares of priceline.com common stock at exercise prices ranging from $315.75 to $359.58 per share. All warrants were fully vested on the date of grant, and are generally exercisable until their expiration in May 2005.

Delta Air Lines holds warrants to purchase 756,199 shares of the Company s common stock at an exercise price of $17.81 per share. These warrants became exercisable upon their issuance and expire in February 2008. Delta Air Lines also holds warrants to purchase 779,166 shares of the Company s common stock at an exercise price of $28.31 per share. These warrants became exercisable in November 2004 and expire in May 2005.

In March 2003, in connection with the renewal of a marketing agreement with Marriott International, Inc., (Marriott) the Company issued Marriott 833,333 warrants to purchase shares of the Company s common stock at an exercise price of $9.84 per share. The warrants, which are not transferable, are fully vested, non-forfeitable, and will be exercisable no earlier than three years from the date of issuance (subject to certain limited exceptions in the event of a reorganization, recapitalization, merger or consolidation involving priceline.com).

15. TAXES

The Company has incurred cumulative net operating losses (NOL s) for financial accounting and tax purposes. The effects of the NOL s have given rise to a substantial deferred tax asset that has been utilized to offset the provision for income taxes on substantially all earnings generated to date within the United States. SFAS No. 109, Accounting for Income Taxes, requires that the Company record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. At March 31, 2005 the Company has provided a valuation allowance for the full amount of the deferred tax asset. The likelihood of realization of deferred tax assets is reviewed periodically. Many factors are considered when assessing the likelihood of future realization including cumulative earnings experience, expectations of future taxable income and the carryforward periods available. While it is the judgment of the Company that realization is not currently more likely than not, a continued pattern of earnings and likelihood of future taxable income could result in a future determination that all or part of the deferred tax asset may be realized.

Beginning in 2004, the Company became subject to Federal Alternative Minimum Tax (AMT) for earnings generated within the United States. The Company recognizes AMT expense at the end of each interim period based on the estimated effective AMT tax rate for the full fiscal year. AMT is not offset against NOL.

The Company recognizes income tax expense related to income generated outside of the United States based upon the applicable tax rates of the foreign countries in which the income is generated. Currently, the substantial majority of the Company s foreign-sourced income is generated in the United Kingdom.

As part of the purchase accounting associated with the acquisition of Active Hotels, the Company has recorded a deferred tax liability in the amount of $22.6 million, primarily related to the assignment of estimated fair value to certain purchased identifiable intangible assets. The deferred tax liability primarily represents an estimate of the differences between future income taxes that will be recognized for financial reporting purposes, as compared to that which will be reported for income tax purposes.

16. COMMITMENTS AND CONTINGENCIES

Acquisition of Active Hotels.

In connection with the Company s acquisition of Active Hotels, the Company sold a 2.3% equity interest in Active Hotels (the Purchased Shares) to a group of Active Hotels employees for a cash purchase price per share equal to the purchase price per share paid by the Company to acquire Active Hotels. The Company also granted restricted stock (the Granted Shares) representing an additional 1.1% equity interest in its Active Hotels subsidiary to certain employees of Active Hotels. The holders of the Purchased Shares and the Granted Shares can require the Company to purchase the Purchased Shares and the Granted shares at certain future dates for a purchase price equal to their then fair market value. In addition, the Company can require the holders of the Purchased Shares and the Granted Shares to sell the Purchased Shares and the Granted Shares to the Company at certain future dates for a purchase price equal to their then fair market value.

Litigation.

On December 30, 2004, the City of Los Angeles filed a putative class action complaint in Superior Court for the County of Los Angeles, on behalf of itself and other allegedly similarly situated cities in California, naming as defendants: Hotels.com, L.P.; Hotels.Com GP., LLC; Hotwire, Inc.; Cheaptickets, Inc.; Cendant Travel Distribution Services Group, Inc.; Expedia, Inc.; Internetwork Publishing Corp. (d/b/a Lodging.com); Lowestfare.com, Inc.; Maupintour Holding LLC; Orbitz, Inc.; Orbitz, LLC; priceline.com, Inc.; Site59.com, LLC; Travelocity.com, Inc.; Travelocity.com LP; Travelweb, LLC; Travelnow.com, Inc. (City of Los Angeles v. Hotels.com, Inc. et al.) The complaint alleges, among other things, that each of these defendants violated the Uniform Transient Occupancy Tax Ordinance of the City of Los Angeles, and allegedly similar ordinances of other California cities, with respect to the charging and remittance of amounts to cover taxes under such ordinances, and that such violations also constitute acts of unfair competition under California Business and Professions Code Section 17200 et seq. (Section 17200). The complaint seeks payment of alleged unpaid taxes owed, relief from conversion, including punitive damages, and imposition of a constructive trust. The Company and its wholly owned subsidiaries, Lowestfare.com and Travelweb, have been served with the complaint. A case management conference is scheduled for May 19, 2005. The court has imposed a stay of proceedings pending that conference. The Company and other defendants are in the process of preparing motions challenging the complaint.

On February 17, 2005, a putative class action complaint was filed in the same court by Ronald Bush and three other individuals on behalf of themselves and other allegedly similarly situated California consumers against several of the same defendants as named in the City of Los Angeles action, including the Company (Bush et al. v. Cheaptickets, Inc. et al.) The complaint alleges each of the defendants engaged in acts of unfair competition in violation of Section 17200 relating to their respective disclosures and charging customers to cover taxes under the above ordinances of City of Los Angeles and other California cities, and service fees. The complaint seeks restitution under Section 17200, relief for alleged conversion, including punitive damages, injunctive relief, and imposition of a constructive trust. The Company was served with the complaint on February 25, 2005. The defendants removed this action to the United States District Court for the Central District of California. The federal court issued an order to show cause why the action should not be remanded to state court, and plaintiffs have filed a motion to remand the action to state court. The parties have briefed the order to show cause and defendants intended to oppose the motion to remand. On May 9, 2005, the District Court issued an order remanding the action to state court. The Company anticipates that the state court will schedule a case management conference similar to the impending conference in the City of Los Angeles action.

Also on February 17, 2005, a putative class action complaint was filed in the Superior Court of Delaware for New Castle County by Jeanne Marshall and three other individuals on behalf of themselves and a putative class of allegedly similarly situated consumers nationwide against the Company. The complaint alleges that the Company violated the Delaware Consumer Fraud Act, Del. Code Ann. Tit. 6, § 2523 relating to its disclosures and charging customers to cover taxes under city hotel occupancy tax ordinances nationwide, and service fees. The complaint seeks damages, including punitive damages, injunctive relief, and imposition of a constructive trust. The Company was served with the complaint on March 2, 2005. On April 21, 2005, the Company filed a motion to dismiss the complaint on the grounds that the superior court lacks jurisdiction because the complaint seeks injunctive relief, and that the complaint fails to allege sufficient facts to state a cause of action. Plaintiffs has served on the Company written requests for production of documents. The Company has moved to stay discovery until a determination of its pending motion to dismiss the complaint. A hearing on the Company's motion for stay is scheduled for May 11, 2005. A hearing on the Company's motion to dismiss is scheduled for June 6, 2005.

The Company intends to defend vigorously against these actions. The Company is unable at this time to predict the outcome of these suits or reasonably estimate a range of possible loss, if any.

On March 16, March 26, April 27, and June 5, 2001, respectively, four putative class action complaints were filed in the U.S. District Court for the Southern District of New York naming priceline.com, Inc., Richard S. Braddock, Jay Walker, Paul Francis, Morgan Stanley Dean Witter & Co., Merrill Lynch, Pierce, Fenner & Smith, Inc., BancBoston Robertson Stephens, Inc. and Salomon Smith Barney, Inc. as defendants (01 Civ. 2261, 01 Civ. 2576, 01 Civ. 3590 and 01 Civ. 4956). Shives *et al*. v. Bank of America Securities LLC *et al*., 01 Civ. 4956, also names other defendants and states claims unrelated to the Company. The complaints allege, among other things, that priceline.com and the individual defendants violated the federal securities laws by issuing and selling priceline.com common stock in priceline.com s March 1999 initial public offering without disclosing to investors that some of the underwriters in the offering, including the lead underwriters, had allegedly solicited and received excessive and undisclosed commissions from certain investors. By Orders of Judge Mukasey and Judge Scheindlin dated August 8, 2001, these cases were consolidated for pre-trial purposes with hundreds of other cases, which contain allegations concerning the allocation of shares in the initial public offerings of companies other than priceline.com, Inc. By Order of Judge Scheindlin dated August 14, 2001, the following cases were consolidated for all purposes: 01 Civ. 2261; 01 Civ. 2576; and 01 Civ. 3590. On April 19, 2002, plaintiffs filed a Consolidated Amended Class Action Complaint in these cases. This Consolidated Amended Class Action Complaint makes similar allegations to those described above but with respect to both the Company s March 1999 initial public offering and the Company s August 1999 second public offering of common stock. The named defendants are priceline.com, Inc., Richard S. Braddock, Jay S. Walker, Paul E. Francis, Nancy B. Peretsman, Timothy G. Brier, Morgan Stanley Dean Witter & Co., Goldman Sachs & Co., Merrill Lynch, Pierce, Fenner & Smith, Inc., Robertson Stephens, Inc. (as successor-in-interest to BancBoston), Credit Suisse First Boston Corp. (as successor-in-interest to Donaldson Lufkin & Jenrette Securities Corp.), Allen & Co., Inc. and Salomon Smith Barney, Inc. Priceline, Richard Braddock, Jay Walker, Paul Francis, Nancy Peretsman, and Timothy Brier, together with other issuer defendants in the consolidated litigation, filed a joint motion to dismiss on July 15, 2002. On November 18, 2002, the cases against the individual defendants were dismissed without prejudice and without costs. In addition, counsel for plaintiffs and the individual defendants executed Reservation of Rights and Tolling Agreements, which toll the statutes of limitations on plaintiffs claims against those individuals. On February 19, 2003, Judge Scheindlin issued an Opinion and Order granting in part and denying in part the issuer s motion. None of the claims against the Company were dismissed. On June 26, 2003, counsel for the plaintiff class announced that they and counsel for the issuers had agreed to the form of a Memorandum of Understanding (the Memorandum) to settle claims against the issuers. The terms of that Memorandum provide that class members will be guaranteed $1 billion in recoveries by the insurers of the issuers and that settling issuer defendants will assign to the class members certain claims that they may have against the underwriters. Issuers also agree to limit their abilities to bring certain claims against the underwriters. If recoveries in excess of $1 billion are obtained by the class from any non-settling defendants, the settling defendants monetary obligations to the class plaintiffs will be satisfied; any amount recovered from the underwriters that is less than $1 billion will be paid by the insurers on behalf of the issuers. The Memorandum, which is subject to the approval of each issuer, was approved by a special committee of the priceline.com Board of Directors on Thursday, July 3, 2003. Thereafter, counsel for the plaintiff class and counsel for the issuers agreed to the form of a Stipulation and Agreement of Settlement with Defendant Issuers and Individuals (Settlement Agreement). The Settlement Agreement implements the MOU and contains the same material provisions. On June 11, 2004, a special committee of the priceline.com Board of Directors authorized the Company s counsel to execute the Settlement Agreement on behalf of the Company. The Settlement Agreement is subject to final approval by the Court and the process to obtain that approval is still pending.

Subsequent to the Company s announcement on September 27, 2000 that revenues for the third quarter 2000 would not meet expectations, it was served with the following putative class action complaints:

Weingarten v. priceline.com Incorporated and Jay S. Walker
3:00 CV 1901 (District of Connecticut).
Twardy v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1884 (District of Connecticut).
Berdakina v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1902 (District of Connecticut).
Mazzo v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1924 (District of Connecticut).
Fialkov v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1954 (District of Connecticut).
Ayach v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2062 (District of Connecticut).
Zia v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1968 (District of Connecticut).

Mazzo v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1980 (District of Connecticut).
Bazag v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2122 (District of Connecticut).
Breier v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2146 (District of Connecticut).
Farzam et al. v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2176 (District of Connecticut).

Caswell v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2169 (District of Connecticut).
Howard Gunty Profit Sharing Plan v. priceline.com Inc.
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1917 (District of Connecticut).
Cerelli v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1918 (District of Connecticut).
Mayer v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1923 (District of Connecticut).
Anish v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1948 (District of Connecticut).
Atkin v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 1994 (District of Connecticut).
Lyon v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2066 (District of Connecticut).
Kwan v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2069 (District of Connecticut).
Krim v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2083 (District of Connecticut).
Karas v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2232 (District of Connecticut).
Michols v. priceline.com Inc.,
Richard S. Braddock, Daniel H. Schulman and Jay S. Walker
3:00 CV 2280 (District of Connecticut).

All of these cases have been assigned to Judge Dominic J. Squatrito. On September 12, 2001, Judge Squatrito ordered that these cases be consolidated under the Master File No. 3:00cv1884 (DJS), and he designated lead plaintiffs and lead plaintiffs counsel. On October 29, 2001, plaintiffs served a Consolidated Amended Complaint. On February 5, 2002, Amerindo Investment Advisors, Inc., who was one of the lead plaintiffs in the consolidated action, made a motion for leave to withdraw as lead plaintiff. The Court granted that motion on May 30, 2002. On February 28, 2002, the Company filed a motion to dismiss the Consolidated Amended Complaint. On October 7, 2004, the Court issued a Memorandum of Decision granting, in part, and denying, in part, the Company s motion. A scheduling order was entered by the Court on November 2, 2004 and the parties are now proceeding with discovery. Plaintiffs filed a motion for class certification on January 7, 2005, to which the Company s opposition is due on May 20, 2005. The Company intends to defend vigorously against this action. The Company is unable to predict the outcome of these suits or reasonably estimate a range of possible loss, if any.

In addition, on November 1, 2000 the Company was served with a complaint that purported to be a shareholder derivative action against its Board of Directors and certain of its current and former executive officers, as well as the Company (as a nominal defendant). The complaint alleged breach of fiduciary duty and waste of corporate assets. The action is captioned Mark Zimmerman v. Richard Braddock, J. Walker, D. Schulman, P. Allaire, R. Bahna, P. Blackney, W. Ford, M. Loeb, N. Nicholas, N. Peretsman, and priceline.com Incorporated, 18473-NC (Court of Chancery of Delaware, County of New Castle, State of Delaware). On February 6, 2001, all defendants moved to dismiss the complaint for failure to make a demand upon the Board of Directors and failure to state a cause of action upon which relief can be granted. Pursuant to a stipulation by the parties, an amended complaint was filed on June 21, 2001. Defendants renewed their motion to dismiss on August 20, 2001, and plaintiff served his opposition to that motion on October 26, 2001. Defendants filed their reply brief on January 7, 2002. On December 20, 2002, the Court granted defendants motion without prejudice. On April 25, 2003, a second amended complaint, adding H. Miller, was filed and a motion seeking leave of court to file the second amended complaint was filed on July 28, 2003. That motion was fully briefed, and oral argument took place on May 9, 2005. Immediately following oral argument, the Court dismissed three of the four counts in the second amended complaint. All of the counts against defendants Allaire, Bahna, Blackney, Ford, Loeb, Miller, Peretsman and Schulman have now been dismissed. The Court has not yet ruled on the one remaining count. The Company intends to defend vigorously against this action. The Company is unable to predict the outcome of the suit or reasonably estimate a range of possible loss, if any.

On November 7, 2003, the Company was served with a complaint that purported to be a shareholder derivative action against its Board of Directors and certain of its current and former executive officers, as well as the Company (as a nominal defendant). The complaint alleged, among other things, breach of fiduciary duty, waste of corporate assets and misappropriation of corporate information. The claims in the complaint appear to be substantially repetitive of the claims pending in the derivative action in Delaware which is described below. The action is captioned Don Powell v. Richard S. Braddock, Jay S. Walker, Daniel H. Schulman, Paul A. Allaire, Ralph M. Bahna, Paul J. Blackney, William E. Ford, Marshall Loeb, N. J. Nicholas, Jr., Nancy B. Peretsman, and Heidi G. Miller and priceline.com Incorporated (Superior Court, Judicial District of Stamford/Norwalk, State of Connecticut). On January 28, 2004, defendants Blackney, Nicholas, Peretsman and Loeb moved to dismiss the complaint for lack of personal jurisdiction. On January 29, 2004, defendant Miller moved to dismiss the complaint for lack of personal jurisdiction and for insufficient service of process. On February 27, 2004, defendants Braddock, Walker, Schulman, Allaire, Bahna, Blackney, Loeb, Nicholas, Peretsman, Miller and priceline.com moved to dismiss the complaint for lack of subject matter jurisdiction and defendants Braddock and Schulman also moved to dismiss the complaint for lack of personal jurisdiction and insufficient service of process. At a hearing on May 3, 2004, the Court stated that it would not rule on the pending motions until the pending motions in the Delaware action described above are decided. The Court conducted a subsequent status conference on January 10, 2005, at which it requested that the parties report back no later than March 15, 2005 on the status of the Delaware derivative suit. On March 15, 2005, the parties informed the Court in writing that the oral argument in the Delaware case had been postponed until May 9, 2005, and that the parties would contact the Court with a status report after that hearing was held. The Company intends to defend vigorously against this action. The Company is unable to predict the outcome of this suit or reasonably estimate a range of possible loss, if any.

On January 6, 1999, the Company received notice that a third party patent applicant and patent attorney, Thomas G. Woolston, purportedly had filed in December 1998 with the United States Patent and Trademark Office a request to declare an interference between a patent application filed by Woolston and the Company s U.S. Patent 5,794,207. The Company is currently awaiting information from the Patent Office regarding whether it will initiate an interference proceeding.

From time to time, the Company has been and expects to continue to be subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of third party intellectual property rights by it. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources, divert management s attention from our business objectives and could adversely affect the Company s business, results of operations, financial condition and cash flows.

Uncertainty regarding payment of sales and hotel occupancy and other related taxes.

On an ongoing basis, the Company conducts a review and interpretation of the tax laws in various states and other jurisdictions relating to the payment of state and local hotel occupancy and other related taxes. In connection with its review, the Company has met and had discussions with taxing authorities in certain jurisdictions but the ultimate resolution in any particular jurisdiction cannot be determined at this time. Currently, hotels collect and remit hotel occupancy and related taxes to the various tax authorities based on the amounts collected by the hotels. Consistent with this practice, the Company recovers the taxes on the underlying cost of the hotel room night from customers and remits the taxes to the hotel operators for payment to the appropriate tax authorities. Several jurisdictions have indicated that they may take the position that sales tax or hotel occupancy tax is applicable to the differential between the price paid by a customer for the Company s service and the cost to the Company of the underlying room. Historically, the Company has not collected taxes on this differential. Some state and local jurisdictions could assert that the Company is subject to hotel occupancy taxes on this differential and could seek to collect such taxes, either retroactively or prospectively or both. Such actions may result in substantial liabilities for past sales and could have a material adverse effect on the Company s business and results of operations. To the extent that any tax authority succeeds in asserting that such a tax collection responsibility exists, it is likely that, with respect to future transactions, the Company would collect any such additional tax obligation from its customers, which would have the effect of increasing the cost of hotel room nights to the Company s customers and, consequently, could reduce its hotel sales. The Company will continue to assess the risks of the potential financial impact of additional tax exposure, and to the extent appropriate, it will reserve for those estimates of liabilities.

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

The following discussion should be read in conjunction with our financial statements, including the notes to those statements, included elsewhere in this Form 10-Q, and the Section entitled Special Note Regarding Forward Looking Statements in this Form 10-Q. As discussed in more detail in the Section entitled Special Note Regarding Forward Looking Statements, this discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause those differences include, but are not limited to, those discussed in Factors That May Affect Future Results.

Overview

General. We are a leading online travel company that offers our customers a broad range of travel services, including airline tickets, hotel rooms, car rentals, vacation packages and cruises. We offer our customers a unique choice: the ability to purchase certain travel services in a traditional, price-disclosed manner or the opportunity to use our unique *Name Your Own Price*® service, which allows our customers to make offers for travel services at discounted prices. At present, we derive substantially all of our revenues from the following sources:

- Transaction revenues from our *Name Your Own Price*® airline ticket, hotel room and rental car services, as well as our vacation packages service;
- Customer processing fees charged in connection with the sale of both *Name Your Own Price*® and price-disclosed airline tickets, hotel rooms and rental cars service;
- Commissions primarily related to the sale of price-disclosed hotel rooms, including those sold in Europe by our subsidiary Active Hotels Ltd., rental cars, cruises and other travel services;
- Worldspan reservation booking fees related to both our *Name Your Own Price*® airline ticket, hotel room and rental car service, and price-disclosed airline tickets and rental car service;
- Transaction revenue from our price-disclosed hotel room service, facilitated principally through our wholly-owned subsidiary Travelweb LLC; and
- Other revenues derived primarily from selling advertising on our websites.

Trends. Our overall financial prospects have been and continue to be significantly dependent upon the sale of leisure airline tickets and, as a result, the health of our business has been directly related to the health of the airline industry. Most domestic airlines, and many of our major suppliers, have experienced, and continue to experience, significant losses. These losses have been compounded by competition from low-cost carriers and, most recently, by high fuel prices, which we believe increase the possibility of the additional bankruptcy and/or the liquidation of one or more of the major domestic airlines. As a result of these and other factors, many of the major airlines have deeply discounted retail airline tickets to maintain market share, simplified fare structures by removing restrictions associated with certain retail airline tickets (see below) and, as discussed in more detail in *Other* below, put pressure on third-party intermediaries like us to reduce airline distribution costs. These actions have had, and continue to have, a detrimental effect on our overall airline business and, in particular, our *Name Your Own Price*® airline ticket service, which represents a significant portion of our total airline ticket revenues.

Deep retail discounting by the airlines negatively affects demand for our *Name Your Own Price*® airline ticket service because it hurts our value proposition and makes users less willing to accept the trade-offs associated with our service for what has become, in many cases, modest fare savings. In addition, decreased airline capacity hurts our business by reducing the levels of inventory available to us and increasing our cost of inventory. Customer offer prices have not kept pace with the increase in our cost of inventory and are, therefore, lower in proportion to our average cost of supply, which has, for the better part of the last two years, materially and negatively affected the number of *Name Your Own Price*® tickets sold.

In addition, in the first quarter 2005, several major airline carriers simplified their retail fare structures, which removed or reduced the restrictions placed on certain fares (for example, certain airlines, such as Delta Air Lines and American Airlines, eliminated certain Saturday-night-stay requirements and reduced certain cancellation/change fees) and reduced the prices of their most expensive fares. These fare restructurings negatively affected our *Name Your Own Price®* airline ticket service in the same manner as retail discounting they hurt our value proposition and make users less willing to accept the trade-offs associated with our *Name Your Own Price®* service.

Despite the trends associated with our *Name Your Own Price®* airline ticket service and a recent slackening of domestic online travel market growth rates, the online travel sector, overall, continues to grow. In the last two years, we have embarked on a strategy to more broadly participate in that growth by expanding our service offerings and markets. In an effort to participate in that growth and counter some of the trends described above, we have taken a number of initiatives to diversify our service offerings. We have taken and expect to continue to take steps to diversify our revenue among non-opaque services, such as by allowing our customers to purchase price disclosed retail airline, hotel and rental car travel services, which we believe will help broaden our customer appeal. To this end, in the fourth quarter of 2003, we began offering customers the ability to purchase airline tickets at disclosed, retail prices. We believe that the results of the launch of our retail airline ticket service, and the related marketing effort, have been positive and total unit sales of airline tickets increased in 2004 for the first time in two years. The launch of a retail airline service has also had a positive effect on gross profit contribution. While some customers presented with a display of low disclosed prices may opt to select such a ticket rather than make an offer for a *Name Your Own Price®* ticket or may make an offer for a *Name Your Own Price®* ticket that is too low to bind, we believe the gross profit contribution from the increased sale of retail airline tickets has, to date, more than offset any loss in the number of *Name Your Own Price®* tickets sold.

As part of our strategy to broaden the appeal of our hotel service and lessen our dependence on our *Name Your Own Price®* airline ticket service, we have invested in and focused our marketing efforts on our non-airline travel services, including, in particular, our hotel business. In 2004, Lowestfare.com, our wholly-owned subsidiary, acquired all of the equity interest in Travelweb. In March 2005, we launched a price disclosed hotel service using inventory from Travelweb on our website, www.priceline.com. Our intent is to provide customers maximum flexibility by allowing them to select a retail price disclosed service or to make use of the *Name Your Own Price®* service.

Additionally, in September 2004, we acquired Active Hotels Ltd., a U.K. based on-line hotel service. We believe the acquisition creates opportunities for us to expand our businesses. For example, Active Hotels has longstanding distribution relationships with a significant number of other European travel sites and we intend to support these relationships by providing access to U.S. travel services. In addition, we believe that we can offer Active Hotels services to our U.S. customer base for European travel.

We also intend to continue to develop our other non-air business, in particular our rental car and vacation package businesses, for which demand remains relatively strong. In May 2004, we launched a new retail rental car search and booking engine on Rentalcars.com, and in June 2004, we implemented that functionality on Breezenet.com. In October 2004, we launched this search and booking engine on priceline.com to allow customers to choose between an opaque or a disclosed rental car offering. In addition, in the second quarter of 2004, we implemented a new feature on our vacation packages path that allows customers to choose between an opaque or a disclosed price flight itinerary. We currently offer vacation package purchasers the opportunity to purchase tickets, transfers, tours, discounted restaurant meals and other services available at their travel destinations. We intend to expand this offering to other travel services. We sell advertising to travel suppliers and others on our owned websites, including www.priceline.com, www.lowestfare.com, www.travelweb.com, www.rentalcars.com, www.breezenet.com and www.mytravelguide.com, a travel information site acquired in 2004 and relaunched with upgraded content in early 2005.

We intend to continue to execute on our strategy of diversifying our service offerings and markets, through both continued internal development of services and, if appropriate, acquisitions. As a result of the initiatives described above, the growth rates for our "agency" businesses, which are generally comprised of our price-disclosed retail services, have, over the recent past, significantly exceeded the growth rates for our "merchant" businesses, which are comprised primarily of our slower-growing "opaque" services.

With respect to our mortgage service, which is offered on our website through pricelinemortgage.com, a joint-venture with EverBank, a federally chartered savings association, interest rates have increased from recent lows, which has resulted in a slowdown in home refinancings and a reduction in the number of loans that pricelinemortgage.com originates. A reduction in loan originations negatively affects the results of pricelinemortgage.com and if this trend continues, our results attributable to pricelinemortgage.com could be significantly negatively impacted.

Other. A number of travel suppliers, particularly airlines, have indicated publicly that, as part of an effort to reduce distribution costs, they intend to reduce their dependence over time on what they view to be expensive distribution channels such as global distribution systems (GDSs). A number of travel suppliers have reached agreements with travel distributors that require rebates of all or part of the fees received from the GDS. We have agreed to rebate certain GDS costs to certain suppliers in exchange for contractual considerations such as those relating to inventory pricing and availability, and expect to continue to do so in the future. Additionally, travel suppliers are encouraging third-party travel intermediaries, such as us, to develop technology enabling direct connections to bypass the GDS. Development of direct connection technology would require the use of information technology resources and could cause us to incur additional operating expenses and delay other projects. We have been and believe that we will continue to be under significant pressure from travel suppliers, including most of the major domestic airlines and many of our significant hotel suppliers, to rebate all or part of the travel booking fees we receive from Worldspan, L.P., our GDS, and to significantly reduce or eliminate their distribution costs. To the extent that we are required to rebate travel booking fees we currently receive from our GDS to travel suppliers, and are unable to recover such amounts by charging customers, or, if one or a number of travel suppliers pull out of our service because they are unhappy with existing distribution costs, it could have a material adverse effect on our business, results of operations and financial condition.

We believe that our success will depend in large part on our ability to maintain profitability, primarily from our leisure travel business, to continue to promote the priceline.com brand and, over time, to offer other travel services on our website. Further terrorist attacks, hostilities in the Middle East or elsewhere, the liquidation of major domestic airlines now in bankruptcy, the bankruptcy of an additional carrier or the withdrawal from our system of a major airline or hotel supplier, could adversely affect our business and results of operations and impair our ability to effectively implement all or some of the initiatives described above. We intend to continue to invest in marketing and promotion, technology and personnel within parameters consistent with attempts to improve operating results. We also intend to broaden the scope of our business, and to that end, we explore strategic alternatives from time to time in the form of, among other things, mergers and acquisitions. Our goal is to improve volume and sustain gross margins in an effort to maintain profitability. The uncertain environment described above makes the prediction of future results of operations difficult, and accordingly, we cannot provide assurance that we will sustain revenue growth and profitability.

Financial Presentation

Starting with the three months ended September 30, 2004, we began reporting online advertising and offline advertising instead of advertising expense on our Consolidated Statement of Operations. We made this change because Travelweb and Active Hotels rely primarily on online advertising to drive their respective businesses, and our acquisitions of Travelweb and Active Hotels have resulted in a large increase in our consolidated online advertising spending. We have added a discussion of the operating metric Gross Bookings , which represents the total dollar value, inclusive of taxes and fees, of all travel services purchased by our customers.

In addition, starting with the three months ended September 30, 2004, we began combining (1) warrant costs with sales and marketing expenses, (2) stock compensation expense with personnel costs and (3) option taxes with general and administrative expenses, in order to better display the total cost of the associated activity.

Recent Accounting Pronouncements

See Note 5 to our Unaudited Consolidated Financial Statements for a description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of operations and financial condition.

Results of Operations

Three Months Ended March 31, 2005 compared to the Three Months Ended March 31, 2004

Operating Metrics

Our financial results are driven by certain operating metrics that encompass the selling activity generated by our travel services. Specifically, sales of airline tickets, hotel room nights and rental car days capture the volume of units purchased by our customers. Gross Bookings capture the total dollar value inclusive of taxes and fees of all travel services purchased by our customers.

The number of airline tickets, hotel room nights and rental car days sold and the related gross bookings were as follows:

	Airline Tickets	Hotel Room Nights	Rental Car Days		Gross Bookings
Three Months ended March 31, 2005	745,000	2.5 million	1.3 million	$	507 million
Three Months ended March 31, 2004	620,000	1.7 million	1.2 million	$	360 million

Airline tickets sold increased by 20.2% for the three months ended March 31, 2005 over the same period in 2004. The increase was driven by the continued success of our retail choice airline ticket service which was launched in the fourth quarter of 2003. The growth was partially offset by a large annualized percentage decrease in sales of opaque airline tickets sold in the period. See *Managements Discussion and Analysis of Financial Condition and Results of Operations Overview Trends* above.

Hotel room nights sold increased by 52.5% for the three months ended March 31, 2005 over the same period in 2004. The increase was driven primarily by the inclusion of hotel room nights sold by Travelweb and Active Hotels both of which were acquired after the first quarter of 2004.

Rental car days sold increased by 5.3% for the three months ended March 31, 2005 over the same period in 2004 due primarily to increases in sales of our retail choice rental car service which was launched in the fourth quarter of 2004.

Gross Bookings increased by 40.8% for the three months ended March 31, 2005 compared to the same period in 2004. The increase was driven primarily by a 108.6% increase in agency bookings for the three months ended March 31, 2005 primarily as a result of (1) the continued success of our retail choice airline ticket service which was launched in the fourth quarter of 2003; and (2) the inclusion of approximately $69.2 million of bookings from Active Hotels, which was acquired in the third quarter of 2004. Gross bookings also increased as a result of a 8.8% increase in merchant bookings for the three months ended March 31, 2005 primarily driven by the inclusion of approximately $26.8 million of bookings from Travelweb which was acquired in the second quarter of 2004.

Revenues

We classify our revenue into three categories:

Merchant revenues are derived from transactions where we are the merchant of record and are responsible for, among other things, collecting receipts from our customers, remitting payments to our suppliers and establishing the price of services we offer. Merchant revenues include (1) the selling price, as established by us, of the opaque airline tickets, hotel rooms and rental cars and are reported on a gross basis; and (2) the amount charged to a customer, less the amount charged by a supplier, in connection with a Travelweb merchant hotel room.

Agency revenues are derived from travel related transactions where we are not the merchant of record and where the prices of our services are determined by third parties. Agency revenues include travel commissions, customer processing fees and Worldspan reservation booking fees and are reported at the net amounts received, without any associated cost of revenue.

Other revenues are derived primarily from advertising on our websites.

We continue to experience a shift in our airline ticket business mix from a historically merchant opaque model to include a growing number of retail, price disclosed tickets. Because merchant tickets are reported gross and retail tickets are recorded on a net basis, airline ticket revenue increases and decreases are impacted by changes in merchant and retail sales mix and gross profit has become an important measure of evaluating growth in our business. Additionally, our acquisitions of Travelweb and Active Hotels during the second and third quarters of 2004, respectively, contributed approximately $11.8 million to our revenues for the three months ended March 31, 2005.

	Three Months Ended March 31, ($000)		% Change
	2005	2004	
Merchant Revenues	$ 217,528	$ 217,011	0.0%
Agency Revenues	14,925	6,448	131.5%
Other Revenues	939	672	39.7%
Total Revenues	$ 233,392	$ 224,131	4.1%

Merchant Revenues

Merchant revenues for the three months ended March 31, 2005 and 2004, consisted primarily of: (1) transaction revenues representing the selling price of *Name Your Own Price®* airline tickets, hotel rooms, rental cars and price disclosed vacation packages; (2) transaction revenues representing the amount charged to a customer, less the amount charged by suppliers in connection with the sale of hotel rooms on Travelweb; (3) customer processing fees charged in connection with the sale of *Name Your Own Price®* airline tickets, hotel rooms and rental cars and (4) ancillary fees, including Worldspan, L.P. reservation booking fees related to *Name Your Own Price®* transactions only.

Merchant revenue for the three months ended March 31, 2005 compared to the same period in 2004 was substantially unchanged. A substantial decrease in the sale of *Name Your Own Price®* airline tickets was partially offset by approximately $4.9 million of revenue from Travelweb, which was acquired in the second quarter of 2004. We believe that the decrease in the number of *Name Your Own Price®* airline tickets sold continued to be due primarily to low retail airline ticket prices and the availability of retail tickets on our website. In particular, we believe that lower retail pricing causes customers who might normally be willing to make the tradeoffs associated with our *Name Your Own Price®* airline service in exchange for savings off of higher retail rates, to purchase travel services at the lower retail rates, or from low-cost carriers, without having to make any trade-offs.

Agency Revenues

Agency revenues for the three months ended March 31, 2005 and 2004 consisted primarily of: (1) processing fees and third-party supplier commissions related primarily to the sale of travel services including the sale of price-disclosed hotels, rental cars, cruises and other travel services; and (2) ancillary fees, including GDS reservation booking fees related to price-disclosed transactions. Agency revenues for the three months ended March 31, 2005 increased from the same period a year ago, primarily as a result of (1) our increased focus on the retail airline ticket business, driven primarily by continued advertising campaigns that feature our retail choice message, and (2) the inclusion of approximately $7.0 million of agency revenue from Active Hotels which was acquired in the third quarter of 2004.

Other Revenues

Other revenues during the three months ended March 31, 2005 and 2004 consisted primarily of: (1) advertising revenues; and (2) fees for referring customers to pricelinemortgage.com for home financing services.

Other revenues for the three months ended March 31, 2005 increased compared to the same period in 2004, primarily as a result of higher on-line advertising revenue.

Cost of Revenues and Gross Profit

	Three Months Ended March 31, ($000)				% Change
		2005		2004	
Cost of Merchant Revenues	$	175,685	$	180,757	(2.8)%
% of Merchant Revenues		80.8%		83.3%	
Cost of Agency Revenues			$		
% of Agency Revenues		0.0%		0.0%	
Cost of Other Revenues			$		
% of Other Revenues		0.0%		0.0%	
Total Cost of Revenues	$	175,685	$	180,757	(2.8)%
% of Revenues		75.3%		80.6%	

Cost of Revenues

During the three months ended March 31, 2005, cost of revenues decreased by approximately $5.1 million, over the same period last year, due primarily to a shift in the mix of merchant revenue generated by services that have higher gross margins. Cost of revenues declined because opaque transactions, whose revenues are recorded gross with a corresponding cost of revenue, represented a smaller percentage of transactions as compared to retail transactions which are recorded net with no corresponding cost of revenues.

Cost of Merchant Revenues

For the three months ended March 31, 2005 and 2004, cost of merchant revenues consisted primarily of: (1) the cost of opaque hotel rooms from our suppliers, net of hotel occupancy tax, (2) the cost of opaque airline tickets from our suppliers, net of the federal air transportation tax, segment fees and passenger facility charges imposed in connection with the sale of airline tickets; (3) the cost of opaque rental cars from our suppliers, net of applicable taxes; and (4) non-cash acquisition related amortization expenses associated with the acquisition of Travelweb. Cost of merchant revenues for the three months ended March 31, 2005, decreased approximately 2.8%, compared to the same period in 2004, due primarily to the shift in the mix of revenue generated by services that generate different levels of gross margins, as discussed above.

Cost of Agency Revenues

Agency revenues are recorded at their net amount, which are amounts received less amounts paid to suppliers, if any, and therefore, there are no costs of agency revenues.

Cost of Other Revenues

For the three months ended March 31, 2005 and 2004, there were no costs of other revenues.

Gross Profit

Total gross profit increased for the three months ended March 31, 2005, as compared to the same period in 2004, by approximately $14.3 million primarily as a result of increased revenue from (1) the inclusion of results from Travelweb and Active Hotels, which were acquired subsequent to the first quarter of 2004; and (2) increased sales of retail services. Total gross margin (gross profit expressed as a percentage of total revenue) increased during the three month period ended March 31, 2005, compared to the same period in 2004, because opaque transactions, whose revenues are recorded gross with a corresponding cost of revenue, represented a smaller percentage of transactions as compared to retail transactions which are recorded net with no corresponding cost of revenues. Because merchant transactions are reported gross and retail transactions are recorded on a net basis, we believe that gross profit has become an increasingly important measure of evaluating growth in our business.

	Three Months Ended March 31, ($000)		% Change
	2005	2004	
Merchant Gross Profit	$ 41,843	$ 36,254	15.4%
Merchant Gross Margin	19.2%	16.7%	
Agency Gross Profit	$ 14,925	$ 6,448	131.5%
Agency Gross Margin	100.0%	100.0%	
Other Gross Profit	$ 939	$ 672	39.7%
Other Gross Margin	100.0%	100.0%	
Total Gross Profit	$ 57,707	$ 43,374	33.0%
Total Gross Margin	24.7%	19.4%	

Merchant Gross Profit

Merchant gross profit consists of merchant revenues less the cost of merchant revenues. For the three months ended March 31, 2005, merchant gross profit increased from the same period in 2004, primarily due to the inclusion of approximately $4.1 million of gross profit from Travelweb, which was acquired in the second quarter of 2004. Merchant gross margin increased primarily because opaque transactions, whose revenues are recorded gross with a corresponding cost of revenue, represented a smaller percentage of transactions in the three months ended March 31, 2005, when compared to retail transactions (primarily Travelweb), which are recorded net with no corresponding cost of revenues.

Agency Gross Profit

Agency gross profit consists of agency revenues, which are recorded net of agency costs, if any. For the three months ended March 31, 2005, agency gross profit increased over the same period in 2004 due to an increase in the sale of retail airline tickets, rental cars and related processing, GDS fees and travel commissions, and the inclusion of the results of Active Hotels, which was acquired in the third quarter of 2004.

Other Gross Profit

During the three months ended March 31, 2005, other gross profit increased from the same periods last year primarily as a result of higher on-line advertising revenues.

Operating Expenses

Advertising

	Three Months Ended March 31, ($000) 2005	2004	% Change
Offline Advertising	$ 11,072	$ 10,664	3.8%
% of Total Gross Profit	19.2%	24.6%	
Online Advertising	$ 9,932	$ 4,741	109.5%
% of Total Gross Profit	17.2%	10.9%	

Offline advertising expenses consist primarily of: (1) television and radio advertising; and (2) agency fees, creative talent and production costs for television and radio commercials. For the three months ended March 31, 2005, offline advertising expenses increased over the same period in 2004 primarily due to an increase in development and production costs for our new advertising campaign. Online advertising expenses consist primarily of banners, pop-ups, keyword searches, affiliate programs and email advertisements. For the three months ended March 31, 2005, online advertising expenses increased over the same period in 2004 primarily due to the inclusion of the online advertising expenses of Travelweb and Active Hotels, which each rely primarily on online advertising to drive their respective businesses. We intend to continue to promote the priceline.com brand aggressively throughout the remainder of 2005.

Sales and Marketing

	Three Months Ended March 31, ($000) 2005	2004	% Change
Sales and Marketing	$ 8,208	$ 6,706	22.4%
% of Total Gross Profit	14.2%	15.5%	

Sales and marketing expenses consist primarily of (1) credit card processing fees associated with merchant transactions; (2) fees paid to third-party service providers that operate our call centers; and (3) provisions for credit card charge-backs. For the three months ended March 31, 2005, sales and marketing expenses, which are variable in nature, increased over the same period in 2004 due to increased gross booking volumes and the inclusion of sales and marketing expenses associated with Travelweb and Active Hotels.

Personnel

	Three Months Ended March 31, ($000) 2005	2004	% Change
Personnel	$ 11,222	$ 8,341	34.5%
% of Total Gross Profit	19.4%	19.2%	

Personnel expenses consist of compensation to our personnel, including salaries, bonuses, taxes, employee health benefits and stock based compensation. For the three months ended March 31, 2005, personnel expenses increased over the same period in 2004 primarily due to additional salary expense resulting from the acquisition of Travelweb and Active Hotels.

General and Administrative

	Three Months Ended March 31, ($000) 2005	2004	% Change
General and Administrative	$ 4,237	$ 3,509	20.7%
% of Total Gross Profit	7.3%	8.1%	

General and administrative expenses consist primarily of: (1) fees for outside professionals; (2) business insurance; and (3) occupancy expenses. General and administrative expenses increased during the three months ended March 31, 2005 over the same period during 2004 due to additional fees for outside professionals, including those related to litigation related expenses and expenses resulting from the acquisitions of Travelweb and Active Hotels.

Information Technology

	Three Months Ended March 31, ($000) 2005	2004	% Change
Information Technology	$ 2,739	$ 2,514	8.9%
% of Total Gross Profit	4.7%	5.8%	

Information technology expenses consist primarily of: (1) system maintenance and software license fees; (2) data communications and other expenses associated with operating our Internet sites; and (3) payments to outside contractors. For the three months ended March 31, 2005, information technology expenses increased from the same period last year primarily due to the inclusion of expenses of Travelweb and Active Hotels.

Depreciation and Amortization

	Three Months Ended March 31, ($000) 2005	2004	% Change
Depreciation and Amortization	$ 5,466	$ 2,220	146.2%
% of Total Gross Profit	9.5%	5.1%	

Depreciation and amortization expenses consist of: (1) amortization of internally developed and purchased software, (2) depreciation of computer equipment, (3) depreciation of leasehold improvements, office equipment and furniture and fixtures, and (4) amortization of intangible assets with determinable lives. For the three months ended March 31, 2005, depreciation and amortization expense increased from the same period in 2004, primarily as a result of depreciation and amortization expenses associated with the acquisitions of Travelweb and Active Hotels.

Interest

	Three Months Ended March 31, ($000) 2005	2004	% Change
Interest Income	$ 1,456	$ 1,110	31.2%
Interest Expense	(1,293)	(566)	(128.4)%
Total	$ 163	$ 544	(70.0)%

For the three months ended March 31, 2005, net interest income on cash and marketable securities increased over the same period in 2004 primarily due to higher overall cash and investment balances as well as higher prevailing interest rates. Interest income was partially offset by interest expense, including coupon interest and amortization of debt issuance costs incurred in connection with the issuance of our $125 million aggregate principal amount 1% Convertible Senior Notes issued in August 2003, and our $100 million aggregate principal amount 2.25% Convertible Senior Notes issued in June 2004.

Other

Other consists primarily of minority interest expense and foreign exchange related gains and losses. This expense increased in the three months ended March 31, 2005 compared to the same period in 2004 primarily due to (1) foreign exchange losses related to our United Kingdom-based foreign operations, (2) foreign exchange losses on hedging activities and (3) the inclusion of Active Hotels subsequent to our acquisition of it.

Taxes

For the three months ended March 31, 2005 we recorded an income tax benefit of $290,000. The benefit relates to a net foreign tax benefit related to the operations of Active Hotels in the U.K. net of federal alternative minimum tax expense on income earned in the United States.

Equity in Income (Loss) of Investees, net

	Three Months Ended March 31, ($000) 2005	2004	% Change
Equity in Income (Loss) of Investees, net	$ 26	$ (126)	120.6%

Equity in income of investees, net for the three months ended March 31, 2005, represented our pro rata share of pricelinemortgage.com s net income. The increase in equity in income of investees was primarily due to the exclusion of our equity in the loss of Travelweb subsequent to our acquisition of Travelweb in May 2004 in the three months ended March 31, 2005. The three months ended March 31, 2004 included our equity in the loss of Travelweb.

Liquidity and Capital Resources

As of March 31, 2005, we had $265.9 million in cash, cash equivalents, short-term investments and restricted cash. Approximately $23.9 million is restricted cash on deposit collateralizing letters of credit issued in favor of certain suppliers and landlords. Also included in restricted cash are amounts held by our credit card processor company. We generally invest excess cash to make such funds readily available for operating purposes. Cash equivalents and short-term investments are primarily comprised of highly liquid, high quality, investment grade debt instruments.

All of our merchant transactions are structured such that we collect cash up front from our customers and then we pay most of our suppliers at a subsequent future date. We therefore tend to experience significant swings in supplier payables depending on the absolute level of our cost of revenue during the last few weeks of every quarter. This can cause volatility in working capital levels and impact cash balances more or less than our operating income would indicate.

Net cash provided by operating activities for the three months ended March 31, 2005 was $22.7 million, resulting from net income of $5.0 million, non-cash items not affecting March 31, 2005 cash flows of $6.7 million and $11.0 million of changes in working capital. The changes in working capital for the three months ended March 31, 2005, were primarily related to a $20.0 million increase in accounts payable and accrued expenses, partially offset by a $8.3 million increase in accounts receivable. The increases in accounts payable and accounts receivable were primarily due to increases in revenues and related cost of revenues attributable to increased hotel, vacation package and rental car transactions. Non-cash items were primarily associated with the depreciation and amortization of property and equipment and intangible assets, primarily those acquired in our acquisitions of Travelweb and Active Hotels. Net cash provided by operating activities for the three months ended March 31, 2004 was approximately $10.7 million, resulting from net income of approximately $5.1 million, non-cash items not affecting first quarter cash flows of approximately $2.7 million, and approximately $2.9 million of changes in working capital. The changes in working capital for the three months ended March 31, 2004, were primarily related to an approximately $8.3 million increase in accounts receivable, and an approximately $9.5 million increase in accounts payable and accrued expenses. The increases in accounts receivable and accounts payable were primarily due to the increase in revenues and related cost of revenues attributable to an increase in hotel, vacation package and rental car transactions. Non-cash items were primarily associated with the depreciation and amortization of property and equipment and intangible assets.

Net cash used in investing activities was $24.6 million for the three months ended March 31, 2005, and net cash provided by investing activities was $71 million for the three months ended March 31, 2004. Investing activities in the three months ended March 31, 2005 was affected by the purchase of short-term investments and marketable securities in the amount of $19.2 million. In both years, net cash used in investing activities was also affected by purchases of property and equipment. During the three months ended March 31, 2005, this amount was higher than previous quarters due to increased spending on capitalized development activities, especially those related to the launch of our retail hotel service, purchases of computer hardware and the inclusion of capital spending by subsidiaries. While we expect total capital expenditures for 2005 to exceed those of 2004, quarterly amounts for the remainder of the year are expected to be below those that took place in the three months ended March 31, 2005. During the three months ended March 31, 2005, we invested $1.0 million in acquisitions. Investing activities for the three months ended March 31, 2004 was affected by maturities of short-term investments and marketable securities of $72.2 million.

Net cash provided by financing activities was approximately $1.1 million and $513,000 for the three months ended March 31, 2005 and 2004, respectively. The cash provided by financing activities during the three months ended March 31, 2005 and March 31, 2004, was primarily proceeds from the exercise of employee stock options.

We believe that our existing cash balances and liquid resources will be sufficient to fund our operating activities, capital expenditures and other obligations through at least the next twelve months. However, if during that period or thereafter, we are not successful in generating sufficient cash flow from operations or in raising additional capital when required in sufficient amounts and on terms acceptable to us, we may be required to reduce our planned capital expenditures and scale back the scope of our business plan, either of which could have a material adverse effect on our forecasted financial condition or results of operations. If additional funds were raised through the issuance of equity securities, the percentage ownership of our then current stockholders would be diluted. There are no assurances that we will generate sufficient cash flow from operations in the future, that revenue growth or sustained profitability will be realized or that future borrowings or equity sales will be available in amounts sufficient to make anticipated capital expenditures or finance our strategies.

Off-Balance Sheet Arrangements.

As of March 31, 2005, we did not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

Sections of this Form 10-Q including, in particular, our Management s Discussion and Analysis of Financial Condition and Results of Operations above, contain forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict; therefore, actual results may differ materially from those expressed, implied or forecasted in any such forward-looking statements.

Expressions of future goals and expectations or similar expressions including, without limitation, may, will, should, could, expects, does no currently expect, plans, anticipates, intends, believes, estimates, predicts, potential, targets, or continue, reflecting something other than historical fact are intended to identify forward-looking statements. The factors described below in the section entitled Factors That May Affect Future Results could cause our actual results to differ materially from those described in the forward-looking statements. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the reports and documents we file from time to time with the Securities and Exchange Commission, particularly the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

Factors That May Affect Future Results

The following risk factors and other information included in this Quarterly Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

We are dependent on the airline industry and certain airlines.

Our financial prospects are significantly dependent upon our sale of leisure airline tickets. Leisure travel, including the sale of leisure airline tickets, is dependent on personal discretionary spending levels. As a result, sales of leisure airline tickets and other leisure travel services tend to decline during general economic downturns and recessions. In addition, unforeseen events, such as terrorist attacks, political instability, regional hostilities, increases in fuel prices, imposition of taxes or surcharges by regulatory authorities, travel-related accidents, travel-related health concerns and unusual weather patterns also may adversely affect the leisure travel industry. As a result, our business also is likely to be affected by those events. Further, work stoppages or labor unrest at any of the major airlines could materially and adversely affect the airline industry and, as a consequence, have a material adverse effect on our business, results of operations and financial condition.

During the three months ended March 31, 2005, sales of airline tickets from our five largest and two largest airline suppliers accounted for approximately 82.0% and 45.0% of total airline tickets sold, respectively. As a result, currently we are substantially dependent upon the continued participation of these airlines in priceline.com in order to maintain and continue to grow our total gross profit.

We currently have 35 airlines participating in the *Name Your Own Price®* system. However, our arrangements with the airlines that participate in our *Name Your Own Price®* system:

- do not require the airlines to make tickets available for any particular routes;
- do not require the airlines to provide any specific quantity of airline tickets;
- do not require the airlines to provide particular prices or levels of discount;

do not require the airlines to deal exclusively with us in the public sale of discounted airline tickets;

often limit the manner in which we can sell inventory and, in the case of our agreement with Delta Air Lines, substantially limits which airlines can participate in the *Name Your Own Price*® system; and

generally, can be terminated upon little or no notice.

As a general matter, during the course of our business, we are in continuous dialogue with our major airline suppliers about the nature and extent of their participation in our system. The significant reduction on the part of any of our major suppliers of their participation in our system either *Name Your Own Price*® or price-disclosed service for a sustained period of time or their complete withdrawal could have a material adverse effect on our business, results of operations and financial condition. Moreover, certain airlines have significantly limited or eliminated sales of airline tickets through opaque channels, preferring to consistently show the lowest available price on their own website. If one or more participating airlines were to further limit or eliminate discounting through opaque channels, it could have a material adverse effect on our business, results of operations and financial condition. In addition, the airline industry has experienced a shift in market share from full-service carriers to low-cost carriers that focus primarily on discount fares to leisure destinations and we expect this trend to continue. Some low-cost carriers, such as Southwest or Jet Blue, do not distribute their tickets through us or other third-party intermediaries.

Due to our dependence on the airline industry, we could be severely affected by changes in that industry, and, in many cases, we will have no control over such changes or their timing. Several major U.S. airlines are struggling financially and have either filed for reorganization under the United States Bankruptcy Code or discussed publicly the risks of bankruptcy. To the extent other major U.S. airlines that participate in our system declare bankruptcy, they may be unable or unwilling to honor tickets sold for their flights. Our policy in such event would be to direct customers seeking a refund or exchange to the airline, and not to provide a remedy ourselves. Because we are the merchant-of-record on sales of *Name Your Own Price*® airline tickets to our customers, however, we could experience a significant increase in demands for refunds or credit card charge-backs from customers, which would materially and adversely affect our operations and financial results. In addition, because *Name Your Own Price*® customers do not choose the airlines on which they are to fly, the bankruptcy of a major U.S. airline or the possibility of a major U.S. airline declaring bankruptcy could discourage customers from using our *Name Your Own Price*® system to book airline tickets.

In addition, given the concentration of the airline industry, particularly in the domestic market, our competitors could exert pressure on other airlines not to supply us with tickets. Moreover, the airlines may attempt to establish their own buyer-driven commerce service or participate or invest in other similar services.

We are dependent on certain hotels.

Our financial prospects are significantly dependent upon the sale of hotel room nights. During the three months ended March 31, 2005, sales of *Name Your Own Price*® hotel room nights from our five largest hotel suppliers accounted for approximately 37.5% of total *Name Your Own Price*® hotel room nights sold. As a result, currently we are substantially dependent upon the continued participation of these hotels in priceline.com s hotel service in order to maintain and continue to grow our total gross profit.

We currently have more than 40 national hotel chains participating in the *Name Your Own Price*® system. However, our arrangements with the hotels that participate in our *Name Your Own Price*® system generally:

- do not require the hotels to make available to our customers any specific quantity of hotel rooms;
- do not require the hotels to provide particular prices or levels of discount;
- do not require the hotels to deal exclusively with us in the public sale of discounted hotel rooms; and
- generally, can be terminated upon little or no notice.

As a general matter, during the course of our business, we are in continuous dialogue with our major hotel suppliers about the nature and extent of their participation in our system. Improving economic conditions are creating increased demand for hotel rooms and some hotels may reduce the amount of inventory they sell through our service or increase the negotiated rates at which they are willing to provide inventory. If hotel occupancy rates improve to the point that our hotel suppliers no longer place the same value on our distribution systems, such suppliers may reduce the amount of inventory they make available through priceline.com, Travelweb and/or Active Hotels. The significant reduction on the part of any of our major suppliers of their participation in our system for a sustained period of time or their complete withdrawal could have a material adverse effect on our business, results of operations and financial condition.

In addition, certain hotels have begun initiatives to reduce margins received by third party intermediaries on disclosed price merchant transactions, which is the primary method we employ to distribute disclosed price hotel room reservations. While Travelweb s agreements with its leading hotel suppliers provide for specified discounts, if one or more participating hotels were to require us to limit our merchant margins, upon contract renewal or otherwise, it could have a material adverse effect on our business, results of operations and financial condition.

Our ability to satisfy customers may be adversely affected by a number of factors outside of our control.

Most domestic airlines, and many of our major suppliers, have experienced, and continue to experience, significant losses. These losses have been compounded by competition from low-cost carriers and, most recently, by high fuel prices. As a result of these and other factors, many of the major airlines have deeply discounted retail airline tickets to maintain market share, which has had a detrimental effect on our business. Deep retail discounting by the airlines affects our demand by hurting the *Name Your Own Price®* value proposition and making users less willing to accept the trade-offs associated with our *Name Your Own Price®* leisure airline tickets service. In particular, we believe that lower retail pricing causes customers who might normally be willing to make the tradeoff associated with our *Name Your Own Price®* service in exchange for savings off of higher retail rates, to purchase travel services at the lower retail rates or from low-cost carriers without having to make any trade-offs.

We rely on the global distribution system of Worldspan, L.P. in the sale of airline tickets, opaque hotel room reservations, and rental car reservations, and Pegasus Solutions, Inc. in the sale of retail hotel reservations. We do not have a back-up GDS and if the Worldspan or Pegasus GDS becomes inaccessible, or partially inaccessible to us, due to system failure or otherwise, for any significant amount of time, our ability to book airline tickets, opaque hotel reservations and rental car reservations in the case of Worldspan, and retail hotel reservations in the case of Pegasus, would be adversely affected, and our results would suffer.

The bankruptcy, discontinuance or consolidation of our suppliers could harm our business.

We are heavily dependent on our suppliers. Two of our largest airline suppliers, United Airlines and U.S. Airways, are currently operating under the protection of federal bankruptcy laws, and certain other major suppliers, including Delta Air Lines, have disclosed publicly the possibility of seeking the protection of the federal bankruptcy laws. If any of our suppliers currently in bankruptcy liquidates or does not emerge from bankruptcy and we are unable to replace such supplier as a participant in priceline.com, our business would be adversely affected. In addition, in the event that another of our major suppliers voluntarily or involuntarily declares bankruptcy and is subsequently unable to successfully emerge from bankruptcy, and we are unable to replace such supplier, our business would be adversely affected. Further, as discussed in *We are dependent on the airline industry and certain airlines*, because our *Name Your Own Price®* customers do not choose the airline, hotel or rental car company on which they are booked, the bankruptcy of a major supplier or even the possibility of a major supplier declaring bankruptcy, could discourage consumers from booking their travel through us. If any or all of such companies discontinue their business, and we are unable to find other suppliers, it would have a material adverse effect on our business, results of operations and financial condition.

If one of our major suppliers merges or consolidates with, or is acquired by, another company that either does not participate in the priceline.com system or that participates on substantially lower levels, the surviving company may elect not to participate in our system or to participate at lower levels than the previous supplier. In addition, fewer independent suppliers reduces opacity and competition among suppliers. In such event, if we are unable to divert sales to other suppliers, our business results of operations and financial condition may be adversely affected.

Intense competition could reduce our market share and harm our financial performance.

We compete with both online and traditional sellers of the services offered on priceline.com. The market for the services we offer is intensely competitive, and current and new competitors can launch new sites at a relatively low cost. In addition, over the recent past, the on-line travel industry has consolidated, a trend we expect to continue. As a result of this consolidation, the major on-line travel companies with which we compete are owned by large well-capitalized companies. For instance, the Cendant Corporation recently acquired and owns, Orbitz.com, Inc., Cheaptickets.com, Lodging.com and ebookers plc, a leading European travel site, and Sabre Group owns Travelocity.com. In addition, InterActive Corp. currently owns Expedia, Hotels.com and Hotwire.com, our primary competitor in the sale of opaque travel services. InterActive has recently announced its intention to spin-off its on-line travel business into Expedia, which, as a stand-alone company, would continue to have significantly greater resources and capital than priceline.com. We may not be able to effectively compete with industry conglomerates such as Cendant or Sabre or Expedia, each of which have access to significantly greater and more diversified resources than we do.

We currently or potentially compete with a variety of companies with respect to each service we offer. With respect to our travel services, these competitors include:

Internet travel services such as Expedia, Hotels.com and Hotwire, all of which are owned by InterActive Corp., Travelocity, which is owned by the Sabre Group and Cheaptickets, Orbitz.com, ebookers plc and Lodging.com, which are owned by the Cendant Corporation;

traditional travel agencies;

individual or groups of airlines, hotels, rental car companies, cruise operators and other travel service providers (all of which may provide services by telephone or through their branded website);

on-line travel search sites such as SideStep.com, Mobissimo.com, Cheapflights.com, FareChase, Kayak.com, or any substantially similar on-line travel search business; and

operators of travel industry reservation databases such as Galileo, Worldspan, L.P. and Amadeus.

Hotwire, which is our primary competitor in the sale of opaque travel services, provides airline tickets, hotel rooms and rental car reservations at disclosed prices, although supplier identity and exact flight times are undisclosed until after the customer agrees to the purchase. In addition, Hotwire recently launched a retail airline ticket offering and implemented functionality that allows users to specify general time bands in which they want to fly. Since its launch, Hotwire has been successful in establishing itself in the online travel marketplace through aggressive advertising, which has had the effect of decreasing our market share in the opaque channel. If we are unable to effectively compete with Hotwire, our business, results of operation and financial condition will be adversely affected.

Competitors of Active Hotels include, among others, Superbreak.com, Bookings.com, venere.com and lastminute.com.

With respect to financial services, competitors of pricelinemortgage.com include banks and other financial institutions and online and traditional mortgage and insurance brokers, including E*Trade, ditech.com, mortgage.com, Quicken Mortgage, E-Loan, Lending Tree, which is owned by InterActive Corp., and iOwn, Inc.

We potentially face competition from a number of large Internet companies and services that have expertise in developing online commerce and in facilitating Internet traffic, including Amazon.com, AOL, MSN, Google.com and Yahoo!, who compete with us either directly or indirectly through affiliations with other e-commerce or off-line companies. For example, in July 2004, Yahoo! acquired FareChase, a travel search-engine that searches for fares and hotel rates at travel supplier and third-party websites, and refers traffic to those sites. If Yahoo! or other portals decide to refer significant traffic to travel search engines, it could result in more competition from supplier websites and higher customer acquisition costs for third-party sites such as ours. Other large companies with strong brand recognition, technical expertise and experience in Internet commerce could also seek to compete with us. Competition from these and other sources could have a material adverse effect on our business, results of operations and financial condition. For example, growth in the trend of utilizing Internet search engines to capture travel demand could require us to invest additional amounts in on-line search advertising in order to maintain market share. In addition, the business of Active Hotels, which relies upon third-party distribution partners that derive substantial business from search engines, could be negatively affected if search engines change their algorithms in a manner that negatively affects such parties search engine ranking.

Many of our current and potential competitors, including Internet directories, search engines and large traditional retailers, have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing, technical and other resources than priceline.com. Some of these competitors may be able to secure products and services on more favorable terms than we can. In addition, many of these competitors may be able to devote significantly greater resources to:

- marketing and promotional campaigns;
- attracting traffic to their websites;
- attracting and retaining key employees;
- securing vendors and inventory; and
- website and systems development.

In addition, many airline, hotel and rental car suppliers have begun to focus on driving online demand to their own websites in lieu of third-party distributors such as us. Certain suppliers have attempted to charge additional fees to customers who book airline reservations through an on-line channel other than their own website. Furthermore, many low cost airlines, who are having increasing success in the marketplace, distribute their inventory exclusively through their own websites. Suppliers who sell on their own websites typically do not charge a processing fee, and, in some instances, offer advantages such as bonus miles or loyalty points, which could make their offerings more attractive to consumers than models like ours.

Increased competition could result in reduced operating margins, loss of market share and damage to our brand. There can be no assurance that we will be able to compete successfully against current and future competitors or that competition will not have a material adverse effect on our business, results of operations and financial condition.

We may lose or be subject to reduction of global distribution system fees.

We rely on fees paid to us by Worldspan, L.P. for travel bookings made through Worldspan, L.P. s global distribution system, or GDS, for a substantial portion of our gross profit and net income. A number of travel suppliers, particularly airlines, have indicated publicly that, as part of an effort to reduce distribution costs, they intend to reduce their dependence over time on what they view to be expensive distribution channels such as GDSs. A number of travel suppliers have reached agreements with travel distributors that require rebates of all or part of the fees received from the GDS. We have agreed to rebate certain GDS costs to certain suppliers in exchange for contractual considerations such as those relating to inventory pricing and availability, and expect to continue to do so in the future. Additionally, travel suppliers are encouraging distributors, such as us, to develop technology enabling direct connections, therefore bypassing the GDS. Development of direct connection technology would require the use of information technology resources and could cause us to incur additional operating expenses and delay other projects. We have been and believe that we will continue to be under pressure from travel suppliers, including most of the major domestic airlines and many of our significant hotel suppliers, to rebate all or part of the travel booking fees we receive from Worldspan, L.P. To the extent that we are required to rebate travel booking fees we currently receive to travel suppliers, and are unable to recover such amounts by charging customers, it could have a material adverse effect on our business, results of operations and financial condition.

In addition, some airlines are exploring alternative global distribution methods recently developed by new entrants to the global distribution marketplace. Such new entrants propose using technology that is less complex than traditional global distribution systems, and that enables the distribution of airline tickets in a manner than that is more cost-effective to the airline suppliers. Our airline suppliers might pressure us to implement such a distribution system, but our contractual obligations to Worldspan would limit our ability to do so during the term of our agreement with Worldspan. If, as a result, any of such suppliers reduces or ceases its participation in priceline.com, it could have a material adverse effect on our business, results of operations and financial condition.

Defending against intellectual property claims could be expensive and disruptive to our business.

From time to time, in the ordinary course of our business, we have been subject to, and are currently subject to, legal proceedings and claims relating to the intellectual property rights of others, and we expect that third parties will continue to assert intellectual property claims, in particular patent claims, against us, particularly as we expand the complexity and scope of our business. We endeavor to defend our intellectual property rights diligently, but intellectual property litigation is extremely expensive and time consuming, and has and is likely to continue to divert managerial attention and resources from the Company s business objectives. Successful infringement claims against us could result in significant monetary liability or prevent us from operating our business, or portions of our business. In addition, resolution of claims may require us to obtain licenses to use intellectual property rights belonging to third parties, which may be expensive to procure, or possibly to cease using those rights altogether. Any of these events could have a material adverse effect on our business, results of operations or financial condition.

Acquisitions could result in operating difficulties.

As part of our business strategy, we acquired a substantial majority of Travelweb LLC in May 2004 and acquired all of the remaining interest in December 2004. In addition, in September 2004, we acquired Active Hotels Ltd., an online hotel booking company based in the United Kingdom. We may enter into additional business combinations and acquisitions in the future. Acquisitions may result in dilutive issuances of equity securities, use of our cash resources, incurrence of debt and amortization of expenses related to intangible assets. In addition, the process of integrating an acquired company, business or technology may create unforeseen operating difficulties and expenditures. The acquisitions of Travelweb and Active Hotels were accompanied by a number of risks, including:

the need to implement or remediate controls, procedures and policies appropriate for a larger public company at companies that prior to the acquisition lacked such controls, procedures and policies;

the difficulty of assimilating the operations and personnel of Travelweb and Active Hotels, which are principally located in Dallas, Texas, and Cambridge, England, respectively, with and into our operations, which are headquartered in Norwalk, Connecticut;

the potential disruption of our ongoing business and distraction of management;

the difficulty of incorporating acquired technology and rights into our services and unanticipated expenses related to such integration;

the failure to further successfully develop acquired technology resulting in the impairment of amounts currently capitalized as intangible assets;

the impairment of relationships with customers of Travelweb, Active Hotels or our own customers as a result of any integration of operations;

the impairment of relationships with employees of Travelweb, Active Hotels or our own business as a result of any integration of new management personnel;

the potential unknown liabilities associated with Travelweb or Active Hotels.

We may experience similar risks in connection with any future acquisitions. We may not be successful in addressing these risks or any other problems encountered in connection with the acquisitions of Travelweb and Active Hotels or that we could encounter in future acquisitions, which would harm our business or cause us to fail to realize the anticipated benefits of our acquisitions. We currently have approximately $209 million assigned primarily to the intangible assets and goodwill of Travelweb and Active Hotels, and therefore, the occurrence of any of the aforementioned risks could result in a material adverse impact, including a material impairment of these assets.

Our growth cannot be assured. Even if we do experience growth, we cannot assure you that we will grow profitably.

Our business strategies are dependent on the growth of our business. For us to achieve significant growth, consumers and travel suppliers must continue to accept our website as a valuable commercial tool. Consumers who have historically purchased travel services using traditional commercial channels, such as local travel agents and calling suppliers directly, must instead purchase these services on our website. Similarly, travel suppliers will also need to accept or expand their use of our website and view our website as an efficient and profitable channel of distribution for their travel products. Our ability to enhance awareness of the priceline.com brands and offer services that will attract and retain a significant number of new consumers and travel suppliers is not certain, and therefore, our growth may be limited.

We may not be successful in entering the retail hotel market.

To date, we have been able to integrate successfully the sale of retail services for our airline and rental car services. We launched a retail service for our hotel service in March 2005. The launch of our retail service for hotels was substantially more complex and required substantially greater financial, human and development resources than did the launch of either our retail airline service or retail rental car service. There can be no assurance that our retail hotel service will have the same degree of market acceptance among consumers that our airline and rental car services have had thus far. Many of our competitors have more experience in the retail hotel market than we do, and have invested significantly more than we have in marketing their services. In addition, we may face difficulty from our suppliers in maintaining access to the inventory necessary to sustain a competitive retail hotel service. Our failure to successfully anticipate, identify and react to any of the difficulties we might face could have an adverse effect on the success of our retail hotel service or our business, results of operations and financial condition.

Travelweb s business model exposes us to certain risks that we have not traditionally experienced in the hotel business.

Travelweb facilitates the purchase of hotel rooms by customers pursuant to a merchant model, which is based on merchant arrangements it makes directly with individual hotel chains and independent hotel properties. Travelweb receives access to inventory directly from a hotel at a negotiated rate, and determines the retail price at which it will offer its services to the consumer, within contractual limitations. Prior to our acquisition of Travelweb in May 2004, we did not have experience with a disclosed-price merchant model hotel service, and there can be no assurance we will have success with such a model in the future.

Many hotels use merchant arrangements with companies like Travelweb to dispose of excess hotel room inventory at wholesale rates. If hotels experience increased demand for rooms, they might reduce the amount of room inventory they make available through Travelweb. The hotel industry has seen a recent improvement in occupancy rates and this could cause hotels to reduce the amount of inventory they make available through Travelweb. Similarly, many hotels distribute room inventory through their own websites and therefore might increase negotiated rates for merchant rate inventory sold through Travelweb, decreasing the margin available to Travelweb.

In addition, Travelweb makes merchant hotel inventory available to certain affiliate travel distributors, including Orbitz, Inc. Such affiliates offer such inventory to consumers. Travelweb s agreement with Orbitz expires in December 2005 and we do not expect the agreement to be renewed. If Orbitz or other affiliates cease distributing Travelweb inventory, or significantly reduce the amount of Travelweb inventory they offer to consumers, the business of Travelweb would be negatively impacted.

Active Hotel s business model exposes us to certain risks that we have not traditionally experienced in the hotel business.

Active Hotels distributes hotel rooms primarily through a retail model, whereby it secures a reservation with a customer s credit card, but is not compensated by the hotel property until such customer checks out of the hotel property. This requires Active Hotels to pursue collection of commissions relating to hotel room reservations from the hotel properties after the customer has completed his or her stay. We do not have extensive experience in collecting commissions from hotel properties and failure to sustain an adequate collection rate could negatively impact the business of Active Hotels.

In addition, Active Hotels relies heavily on various third parties to distribute hotel room reservations, and Active Hotel s distribution channels are concentrated among a number of third parties. Should one or more of such third parties cease distribution of Active Hotels reservations, or suffers a deterioration in its search engine ranking, its business could be negatively affected.

Historically, the majority of Active Hotels business is located in the U.K. The strategy of Active Hotels involves rapid expansion into other European countries, many of which have different customs, different levels of customer acceptance of the Internet and different legislation, regulatory environments and tax schemes. If Active Hotels is unsuccessful in rapidly expanding into other European countries, our business, results of operations and financial condition would be adversely affected.

Our international operations and additional expansion efforts internationally expose us to additional risks and may materially adversely affect our results of operations.

Prior to 2004, substantially all of our revenues were generated within the United States. In September 2004, we acquired Active Hotels, which is based in the United Kingdom and provides us with access to the European hotel market. One of our principal strategies is to continue to grow internationally, both in Europe and elsewhere. The integration of Active Hotels, and any further expansion internationally, requires and will continue to require substantial management attention and financial resources. Our management has limited prior experience integrating and managing international operations. Moreover, acquiring or establishing foreign operations is a significant investment that might not produce desired results. For example, we may experience higher costs as a percentage of revenues in connection with the development and maintenance of our business internationally relative to our domestic experience.

Additionally, like our current foreign operations, any future acquisitions or expansion internationally would be subject to risks, including:

- the impact of business cycles and downturns in economies outside the United States;
- longer payment cycles and greater difficulty in accounts receivable collections;
- time and resources required to comply with foreign regulatory requirements;
- trade barriers and unexpected changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;
- potentially adverse tax, legal or regulatory consequences;
- reduced protection for intellectual property rights in some countries;
- unanticipated tax costs associated with the cross-border use of intangible assets;
- political or social unrest or economic instability;
- fluctuations in currency exchange rates;
- difficulty in maintaining effective communications with employees and customers due to distance, language and cultural barriers;

lower brand recognition for priceline.com and our other brands in foreign countries, particularly in non-English speaking countries;

lower per capita Internet usage in many foreign countries for a variety of reasons, including lower disposable incomes, lack of adequate telecommunications and computer infrastructure and concerns regarding online security for e-commerce transactions; and

competition in international markets from a broad range of competitors who may have a greater market share, more established branding, greater knowledge with respect to the tastes and preferences of customers residing in their country and/or their focus on a single market.

One or more of these factors could harm our international operations and expansion efforts, and consequently, could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to keep up with rapid technological and other changes.

The markets in which we compete are characterized by rapidly changing technology, evolving industry standards, consolidation, frequent new service and product announcements, introductions and enhancements and changing consumer demands. We may not be able to keep up with these rapid changes. In addition, these market characteristics are heightened by the emerging nature of the Internet and the apparent need of companies from many industries to offer Internet-based products and services. As a result, our future success will depend on our ability to adapt to rapidly changing technologies, to adapt our services to evolving industry standards and to continually improve the performance, features and reliability of our service in response to competitive service and product offerings and the evolving demands of the marketplace. In addition, the widespread adoption of new Internet, networking or telecommunications technologies or other technological changes could require us to incur substantial expenditures to modify or adapt our services or infrastructure.

Online security breaches could harm our business.

The secure transmission of confidential information over the Internet is essential in maintaining consumer and supplier confidence in the priceline.com service. Substantial or ongoing security breaches whether instigated internally or externally on our system or other Internet-based systems could significantly harm our business. We currently require buyers to guarantee their offers with their credit card, either online or through our toll-free telephone service. We rely on licensed encryption and authentication technology to effect secure transmission of confidential information, including credit card numbers. It is possible that advances in computer capabilities, new discoveries or other developments could result in a compromise or breach of the technology used by us to protect customer transaction data.

We incur substantial expense to protect against and remedy security breaches and their consequences. However, we cannot guarantee that our security measures will prevent security breaches. A party (whether internal, external, an affiliate or unrelated third party) that is able to circumvent our security systems could steal proprietary information or cause significant interruptions in our operations. For instance, several major websites have experienced significant interruptions as a result of improper direction of excess traffic to those sites, and computer viruses have substantially disrupted e-mail and other functionality in a number of countries, including the United States. Security breaches also could damage our reputation and expose us to a risk of loss or litigation and possible liability. Security breaches could also cause customers and potential customers to lose confidence in our security, which would have a negative effect on the value of our brand. Our insurance policies carry low coverage limits, which may not be adequate to reimburse us for losses caused by security breaches.

Companies that we have acquired, such as Travelweb and Active Hotels, and that we may acquire in the future, may employ security and networking standards at levels we find unsatisfactory. The process of enhancing infrastructure to attain improved security and network standards may be time consuming and expensive and may require resources and expertise that are difficult to obtain. Such acquisitions increase the number of potential vulnerabilities, and can cause delays in detection of an attack, as well as the timelines of recovery from any given attack. Failure to raise any such standards that we find unsatisfactory could expose us to security breaches that would have an adverse impact on our business, results of operations and financial condition.

We also face risks associated with security breaches affecting third parties conducting business over the Internet. Consumers generally are concerned with security and privacy on the Internet, and any publicized security problems could inhibit the growth of the Internet and, therefore, the priceline.com service as a means of conducting commercial transactions.

We rely on the value of the priceline.com brand, and the costs of maintaining and enhancing our brand awareness are increasing.

We believe that maintaining and expanding the priceline.com brand, and other owned brands, including Lowestfare.com, Rentalcars.com, Breezenet.com, MyTravelGuide.com, Travelweb and Active Hotels, are important aspects of our efforts to attract and expand our user and advertiser base. As our larger competitors spend increasingly more on advertising, we are required to spend more in order to maintain our brand recognition. Promotion of the priceline.com brand will depend largely on our success in satisfying our customers. In addition, we have spent considerable money and resources to date on the establishment and maintenance of the priceline.com brands, and we will continue to spend money on, and devote resources to advertising, marketing and other brand-building efforts to preserve and enhance consumer awareness of the priceline.com brands. We may not be able to successfully maintain or enhance consumer awareness of the priceline.com brands, and, even if we are successful in our branding efforts, such efforts may not be cost-effective. If we are unable to maintain or enhance customer awareness of the priceline.com brands in a cost-effective manner, our business, results of operations and financial condition would be adversely affected.

We issued $125 million of Convertible Senior Notes due August 2010, which provide for mandatory repayment beginning in 2008 and could result in dilution of our earnings per share.

In August 2003, we issued $125 million aggregate principal amount of Convertible Senior Notes due August 1, 2010, with an interest rate of 1% (the 1% Notes). The 1% Notes are convertible, subject to certain conditions, into our common stock at the option of the holder, at a *conversion price of approximately $40.00 per share, subject to adjustment upon the occurrence of specified events. Each $1,000 principal amount of 1% Notes will initially be convertible into 25 shares of our common stock if, on or prior to August 1, 2008, the closing price of our common stock for at least 20 trading days in the 30 consecutive trading days ending on the first day of a conversion period, as defined in the offering memorandum related to the 1% Notes, is more than 110% of the then current conversion price of the 1% Notes, or after August 1, 2008, if the closing price of our common stock is more than 110% of the then current conversion price of the 1% Notes. The 1% Notes are also convertible in certain other circumstances set forth in the offering memorandum, such as a change in control of priceline.com. In addition, the 1% Notes will be redeemable at our option beginning in 2008, and the holders may require us to repurchase the 1% Notes on August 1, 2008 or in certain other circumstances. While we currently have sufficient cash and short-term investments to repay the 1% Notes, there can be no assurance that we will be able to* *repay or refinance the 1% Notes on the repayment date. In addition, the purchase of the 1% Notes with shares of our common stock or the conversion of the 1% Notes into our common stock could result in dilution of our earnings per share. Further, the adoption by the Financial Accounting Standards Board of EITF Issue No. 04-08, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, which was effective as of December 15, 2004, requires that contingently convertible debt, such as the 1% Notes, be included in diluted earnings per share, regardless of whether the market price contingently contained in the debt instrument has been met. We have historically excluded the potential dilutive effect of the conversion feature from diluted earnings per share. The 1% Notes were dilutive to earnings per share for the full year 2004, but not for 2003.* The adoption of EITF 04-08 required us to include approximately 3,125,000 additional shares of common stock underlying the 1% Notes and in our diluted earnings per share calculation in the event that their inclusion is dilutive to earnings per share. The impact of the additional shares in the calculation of diluted earnings per share is partially offset by exclusion of coupon interest and amortization of debt issuance costs associated with the Notes. The adoption of EITF 04-08 could result in a material reduction in our diluted earnings per share in future periods. See Management s Discussion and Analysis of Financial Condition and Results of Operations Recent Accounting Pronouncements.

We issued $100 million of Convertible Senior Notes due January 15, 2025, which provide for mandatory repayment beginning in 2010 and could result in dilution of our earnings per share.

In June 2004, we issued $100 million aggregate principal amount of Convertible Senior Notes due January 15, 2025, with an interest rate of 2.25% (the 2.25% Notes). The 2.25% Notes are convertible, subject to certain conditions, into our common stock at the option of the holder, at a conversion price of approximately $37.95 per share, subject to adjustment upon the occurrence of specified events. Each $1,000 principal amount of 2.25% Notes will initially be convertible into 26.3505 shares of our common stock if, on or prior to January 15, 2025, certain conditions occur. The 2.25% Notes are also convertible in certain other circumstances set forth in the offering memorandum, such as a change in control of priceline.com. In the event that all or substantially all of our common stock is acquired prior to January 15, 2010, in a transaction in which the consideration paid to holders of our common stock consists of all or substantially all cash, we would be required to make additional payments to the holders of amounts ranging from $0 to $19.1 million depending upon the date of the transaction and our then current stock price. In addition, the 2.25% Notes will be redeemable at our option beginning January 20, 2010, and the holders may require us to repurchase the notes on January 15, 2010, 2015 and 2020 or in certain other circumstances. While we currently have sufficient cash and short-term investments to repay the 2.25% Notes, there can be no assurance that we will be able to repay or refinance the notes on the repayment date. In addition, the purchase of our 2.25% Notes with shares of our common stock or the conversion of the notes into our common stock could result in dilution of our earnings per share. Further, the adoption by the Financial Accounting Standards Board of EITF Issue No. 04-08, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, which was effective as of December 15, 2004, requires that contingently convertible debt, such as the 2.25% Notes, be included in diluted earnings per share, regardless of whether the market price contingently contained in the debt instrument has been met. We have historically excluded the potential dilutive effect of the conversion feature from diluted earnings per share. The 2.25% Notes were not dilutive to earnings per share since their issuance. The adoption of EITF 04-08 required us to include approximately 2,635,046 additional shares of common stock underlying the 2.25% Notes and in our diluted earnings per share calculation in the event that their inclusion is dilutive to earnings per share. The impact of the additional shares in the calculation of diluted earnings per share was offset by exclusion of coupon interest and amortization of debt issuance costs associated with the Notes. The adoption of EITF 04-08 could result in a material reduction in our diluted earnings per share in future periods. See Management s Discussion and Analysis of Financial Condition and Results of Operations Recent Accounting Pronouncements.

Our success depends on our ability to protect our intellectual property.

We regard our intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. If we are not successful in protecting our intellectual property, it could have a material adverse effect on our business, results of operations and financial condition.

While we believe that our issued patents and pending patent applications help to protect our business, there can be no assurance that:

- any patent can be successfully defended against challenges by third parties;
- pending patent applications will result in the issuance of patents;

competitors or potential competitors of priceline.com will not devise new methods of competing with us that are not covered by our patents or patent applications;

because of variations in the application of our business model to each of our services, our patents will be effective in preventing one or more third parties from utilizing a copycat business model to offer the same service in one or more categories;

new prior art will not be discovered which may diminish the value of or invalidate an issued patent;

a third party will not have or obtain one or more patents that prevent us from practicing features of our business or require us to pay for a license to use those features; or

our operations do not or will not infringe valid, enforceable patents of third parties.

There has been recent discussion in the press regarding the examination and issuance of so called business-method patents. As a result, the United States Patent and Trademark Office has indicated that it intends to intensify the review process applicable to such patent applications. The new procedures are not expected to have a direct effect on patents already granted. We cannot anticipate what effect, if any, the new review process will have on our pending patent applications.

We pursue the registration of our trademarks and service marks in the U.S. and internationally. However, effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are made available online. We have licensed in the past, and expect to license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. These licensees may take actions that might diminish the value of our proprietary rights or harm our reputation.

Our business is dependent upon third-party systems and service providers.

We rely on certain third-party computer systems and third-party service providers, including the computerized central reservation systems of the airline, hotel and rental car industries to satisfy demand for airline tickets, hotel room and rental car reservations. In particular, our travel business is substantially dependent upon the computerized reservation systems of Worldspan, L.P., and Pegasus Solutions, operators of global distribution systems for the travel industry. Any interruption in these third-party services systems, including Worldspan, L.P. s or Pegasus systems, or deterioration in their performance could prevent us from booking airline, hotel and rental car reservations and have a material adverse effect on our business. Our agreements with third-party service providers are terminable upon short notice and often do not provide recourse for service interruptions. In the event our arrangement with any of such third parties is terminated, we may not be able to find an alternative source of systems support on a timely basis or on commercially reasonable terms and, as a result, it could have a material adverse effect on our business, results of operations and financial condition.

A substantial portion of our computer hardware for operating our services is currently located at a web hosting facility operated by SAVVIS. If SAVVIS is, for any reason, unable to support our website, we would need to quickly complete the activation of our secondary site at the ATT web hosting facility. Any of these conditions could cause disruptions to our business or exposure to potentially damaging press coverage of the problems, and would have a material adverse effect on our business, results of operations, and financial condition.

Our communications infrastructure is provided by vendors such as AT&T, MCI and IX EUROPE. If they are unable, for any reason, to support the communications infrastructure they provide us, instabilities in our systems could increase until such time as we were able to replace their services.

While we do maintain redundant systems and hosting services for some of our business, it is possible that we could experience an interruption in our business, and we do not carry business interruption insurance sufficient to compensate us for losses that may occur.

Capacity constraints and system failures could harm our business.

We rely on the global distribution system of Worldspan, L.P. in the sale of airline tickets, opaque hotel room reservations, and rental car reservations, and the global distribution system of Pegasus Solutions in the sale of retail hotel room reservations. We do not have a back-up GDS and if the Worldspan or Pegasus GDS becomes inaccessible, or partially inaccessible to us, due to system failure or otherwise, for any significant amount of time, our ability to book airline tickets, opaque and retail hotel reservations and rental car reservations would be adversely affected, and our results would suffer. We also depend upon Paymentech for our production fulfillment processes. If Paymentech was wholly or partially compromised, our cash flows could be disrupted until such a time as a replacement process could be put in place with a different vendor.

A substantial amount of our computer hardware for operating our services is currently located at the facilities of SAVVIS in New Jersey and IX EUROPE in London, England. These systems and operations are vulnerable to damage or interruption from human error, floods, fires, power loss, telecommunication failures and similar events. They are also subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems at the SAVVIS facility or the IX EUROPE facility could result in lengthy interruptions in our services. In addition, the failure by SAVVIS or IX EUROPE to provide our required data communications capacity could result in interruptions in our service. Any system failure that causes an interruption in service or decreases the responsiveness of the priceline.com service could impair our reputation, damage our brand name and have a material adverse effect on our business, results of operations and financial condition.

If our systems cannot be expanded to cope with increased demand or fails to perform, we could experience:

- unanticipated disruptions in service;
- slower response times;
- decreased customer service and customer satisfaction; or
- delays in the introduction of new products and services,

any of which could impair our reputation, damage the priceline.com brand and materially and adversely affect our revenues. Publicity about a service disruption also could cause a material decline in our stock price.

Like many online businesses, we have experienced system failures from time to time. For example, in May 2001, our primary website was interrupted for a period of 12 hours. In addition to placing increased burdens on our engineering staff, these outages create a significant amount of user questions and complaints that need to be addressed by our customer support personnel. Any unscheduled interruption in our service could result in an immediate loss of revenues that can be substantial and may cause some users to switch to our competitors. If we experience frequent or persistent system failures, our reputation and brand could be permanently harmed. We have been taking steps to increase the reliability and redundancy of our system. These steps are expensive, may reduce our margins and may not be successful in reducing the frequency or duration of unscheduled downtime.

We use both internally developed systems and third-party systems to operate the priceline.com service, including transaction processing, order management and financial systems that were designed to be scaleable and stable. However, if the number of users of our services increases substantially, or if critical third-party systems stop operating as designed, we will need to significantly expand and upgrade our technology, transaction processing systems, financial systems and other infrastructure. We do not know whether we will be able to upgrade our systems and infrastructure to accommodate such conditions in a timely manner.

Companies that we have acquired, such as Travelweb and Active Hotels, and that we may acquire in the future, may present known or unknown capacity/stability or other types of system challenges. The process of enhancing infrastructure to attain improved capacity/scalability and other system characteristics may be time consuming and expensive and may require resources and expertise that are difficult to obtain. Such acquisitions increase potential downtime, customer facing problems and compliance problems. Failure to successfully make any such improvements to such infrastructures could expose us to potential capacity, stability, and system problems that would have an adverse impact on our business, results of operations and financial condition.

Uncertainty regarding payment of sales and hotel occupancy taxes.

On an ongoing basis, we conduct reviews and interpretations of the tax laws in various states and other jurisdictions relating to the payment of state and local hotel occupancy and other related taxes. In connection with our reviews, we have met and had discussions with taxing authorities in certain jurisdictions but the ultimate resolution in any particular jurisdiction cannot be determined at this time. Currently, hotels collect and remit hotel occupancy and related taxes to the various tax authorities based on the amounts collected by the hotels. Consistent with this practice, we recover the taxes on the underlying cost of the hotel room night from customers and remit the taxes to the hotel operators for payment to the appropriate tax authorities. Several jurisdictions have indicated that they may take the position that hotel occupancy tax is applicable to the differential between the price paid by a customer for our service and the cost to us of the underlying room. Historically, we have not collected taxes on this differential. Some state and local jurisdictions could assert that we are subject to sales or hotel occupancy taxes on this differential and could seek to collect such taxes, either retroactively or prospectively or both. Such actions may result in substantial tax liabilities for past sales and could have a material adverse effect on our business and results of operations. To the extent that any tax authority succeeds in asserting that any such tax collection responsibility exists, it is likely that, with respect to future transactions, we would collect any such additional tax obligation from our customers, which would have the effect of increasing the cost of hotel room nights to our customers and, consequently, could reduce our hotel sales. We will continue to assess the risks of the potential financial impact of additional tax exposure, and to the extent appropriate, we will reserve for those estimates of liabilities.

Uncertainty regarding state and local taxes.

We file tax returns in such states as required by law based on principles applicable to traditional businesses. In addition, we pay sales and other taxes to suppliers on our purchases of travel services sold through the priceline.com service. In certain cases, where appropriate, we remit taxes directly to the tax authorities. We believe that this practice is consistent with the tax laws of all jurisdictions. However, one or more states could seek to impose additional income tax obligations, sales tax collection obligations or other tax obligations on companies, such as ours, which engage in or facilitate online commerce. A number of proposals have been made at state and local levels that could impose such taxes on the sale of products and services through the Internet or the income derived from these sales. To the extent that any tax authority succeeds in asserting that a tax collection responsibility applies to transactions conducted through the priceline.com service, we might have additional tax exposure. Such actions could have a material adverse effect on our business and results of operations. We will continue to assess the risks of the potential financial impact of additional tax exposure, and to the extent appropriate, we will reserve for those estimates of liabilities.

Current economic conditions in the United States are triggering active consideration on ways to generate additional tax revenues by both the federal and state and local governments. We cannot predict what changes in tax law or interpretations of such laws may be adopted or assure that such changes or interpretations would not materially impact our business.

We are exposed to fluctuations in currency exchange rates.

As a result of our acquisition of Active Hotels, we will conduct a significant and growing portion of our business outside the United States but will report our results in U.S. dollars. As a result, we will face exposure to adverse movements in currency exchange rates. In addition, the results of operations of Active Hotels are exposed to foreign exchange rate fluctuations as the financial results of Active Hotels are translated from local currency into U.S. dollars upon consolidation. If the U.S. dollar weakens against the local currency, the translation of these foreign-currency-denominated transactions will result in increased net revenues, operating expenses, and net income. Similarly, our net revenues, operating expenses, and net income will decrease if the U.S. dollar strengthens against local currency.

Our business is exposed to risks associated with credit card fraud and charge-backs.

To date, our results have been negatively impacted by purchases made using fraudulent credit cards. Because we act as the merchant-of-record in a majority of our transactions, we may be held liable for accepting fraudulent credit cards on our website as well as other payment disputes with our customers. Additionally, we are held liable for accepting fraudulent credit cards in certain retail transactions when we do not act as merchant of record. Accordingly, we calculate and record an allowance for the resulting credit card charge-backs. If we are unable to combat the use of fraudulent credit cards on our website, our business, results of operations and financial condition could be materially adversely affected.

Two large stockholders beneficially own approximately 33% of our stock.

Hutchison Whampoa Limited and its 49.97% shareholder, Cheung Kong (Holdings) Limited, collectively beneficially owned approximately 33% of our outstanding common stock as of March 31, 2005, based on public filings with the SEC. Together, Cheung Kong (Holdings) Limited and Hutchison Whampoa Limited have appointed three of the eleven members of our Board of Directors. As a result of their ownership and positions, Cheung Kong (Holdings) Limited and Hutchison Whampoa Limited collectively are able to significantly influence all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Such concentration of ownership may also have the effect of delaying or preventing a change in control of our company. In addition, both Cheung Kong (Holdings) Limited and Hutchison Whampoa Limited have registration rights with respect to their shares of priceline.com. On May 4, 2004, we filed with the Securities and Exchange Commission a shelf registration statement covering, among other things, up to 10 million shares of our common stock held by Hutchison Whampoa Limited and Cheung Kong (Holdings) Limited. The shelf registration statement was declared effective on May 20, 2004, and therefore, there can be no assurance that Cheung Kong (Holdings) Limited, Hutchison Whampoa Limited, or both, will not dispose of all or substantially all of our common stock held by them at any time. Sales of significant amounts of shares held by Cheung Kong (Holdings) Limited or Hutchison Whampoa Limited, or the prospect of these sales, could adversely affect the market price of our common stock.

Fluctuations in our financial results make quarterly comparisons and financial forecasting difficult.

Our revenues and operating results have varied significantly from quarter to quarter because our business experiences seasonal fluctuations, which reflect seasonal trends for the travel services offered by our websites. Traditional leisure travel bookings in the United States are higher in the second and third calendar quarters of the year as consumers take spring and summer vacations. In the first and fourth quarters of the calendar year, demand for travel services in the United States generally declines and the number of bookings flattens. Travel revenues for Active Hotels in Europe, on the other hand, have been higher in the third and fourth quarters than in the first and second quarters. Our results may also be affected by seasonal fluctuations in the inventory made available to us by airlines, hotels and rental car suppliers. Our revenues and operating results may continue to vary significantly from quarter to quarter because of these factors. As a result, quarter-to-quarter comparisons of our revenues and operating results may not be meaningful. In addition, due to our limited operating history, a relatively new and unproven business model and an uncertain environment in the travel industry, it may be difficult to predict our future revenues or results of operations.

Because of these fluctuations and uncertainties, our operating results may fail to meet the expectations of securities analysts and investors. If this happens, the trading price of our common stock would almost certainly be materially adversely affected.

If we lose our key personnel or cannot recruit additional personnel, our business may suffer.

We depend on the continued services and performance of our executive officers and other key personnel. These individuals have acquired specialized knowledge and skills with respect to priceline.com and our operations. We do not have key person life insurance policies. Our ability to retain key employees could be materially adversely affected by the decline in the market price of our common stock, limitations on our ability to pay cash compensation that is equivalent to cash paid by traditional businesses or, in some instances, larger or better capitalized competitors, and limitations imposed by our employee benefit plans on our ability to issue additional equity incentives. If we do not succeed in attracting new employees or retaining and motivating current and future employees or executive officers, our business could suffer significantly.

The adoption by FASB of FASB Statement No. 123 (Revised 2004), Share-Based Payment, will negatively impact our reported business results.

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004) (SFAS 123 (R)), Share-Based Payment , which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) eliminates the ability to account for share-based compensation transactions using the intrinsic value method prescribed by Accounting Principles Board, Opinion No. 25, Accounting for Stock Issued to Employees, and requires that such transactions be accounted for using a fair-value-based method and recognized as expenses in our Consolidated Statement of Operations. SFAS 123(R) allows the modified prospective method to be used, which requires that the fair value of new awards granted from the beginning of the year of adoption (plus unvested awards at the date of adoption) be expensed over the vesting term. We will be required to apply SFAS 123(R) as of January 1, 2006. SFAS 123(R) will have a significant impact on our Consolidated Statement of Operations as we will be required to expense the fair value of our stock option grants rather than disclose the impact on our consolidated operations within our footnotes. Upon adoption of SFAS 123(R), the impact of unvested stock options granted as of March 31, 2005 is estimated to increase personnel expense by $5.8 million in 2006 and $2.0 million in 2007.

It is possible that our financial results will be materially impacted by income taxes in the future.

We have historically incurred cumulative net operating losses (NOL s) for financial accounting and tax purposes. The effects of the NOL s have given rise to a substantial deferred tax asset that has been utilized to offset the provision for income taxes on substantially all earnings generated to date within the United States. SFAS No. 109, Accounting for Income Taxes , requires that we record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. At March 31, 2005, we have provided a valuation allowance for the full amount of the deferred tax asset. If, in the future, we determine that it is more likely than not that we will generate sustainable pre-tax net income within the United States in an amount that allows us to utilize our deferred tax asset, we will be required to reverse all or a portion of the deferred tax asset valuation allowance. If we reverse any part of the valuation allowance, our reported financial results for the period during which we reverse the valuation allowance would be positively impacted in an amount equal to the dollar amount of the valuation allowance reversal and our Consolidated Balance Sheets would reflect the revised carrying value of our deferred tax asset. In reporting periods subsequent to the reversal of our valuation allowance, our reported financial results would include a provision for income taxes based upon the full prevailing blended federal and state tax rates. While such a provision is expected to be substantially non-cash in nature, our future reported net income and earnings per share would be materially negatively impacted.

The use of our deferred tax asset is also subject to limitation under section 382 of the Internal Revenue Code of 1986. Section 382 imposes limitations on the use of company s deferred tax assets in the event that a 50-percentage point ownership change occurs in the shareholdings of our common stock. As a result of a study (the NOL Study), it was determined that ownership changes occurred in 2000 and 2002 that had the effect of limiting the amount of deferred tax asset that can be used to offset future taxable income to approximately $69 million annually over the carryforward period. The estimate of the value of the tax asset is based upon certain conclusions in the NOL Study pertaining to the dates of the ownership changes and the value of the Company on the dates of the ownership changes. The conclusions contained in the NOL Study are subject to interpretation, and therefore, the value of the deferred tax asset could be subject to change. The value of the deferred tax asset could also be materially impaired in the event that another change of control occurs.

Our stock price is highly volatile.

The market price of our common stock is highly volatile and is likely to continue to be subject to wide fluctuations in response to factors such as the following, some of which are beyond our control:

quarterly variations in our operating results;

operating results that vary from the expectations of securities analysts and investors;

changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

changes in our capital structure;

changes in market valuations of other Internet or online service companies;

announcements of technological innovations or new services by us or our competitors;

announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

loss of a major supplier participant, such as an airline or hotel chain;

changes in the status of our intellectual property rights;

lack of success in the expansion of our business model geographically;

announcements by third parties of significant claims or proceedings against us or adverse developments in pending proceedings;

additions or departures of key personnel; and

stock market price and volume fluctuations.

Sales of a substantial number of shares of our common stock could adversely affect the market price of our common stock by introducing a large number of sellers to the market. Given the volatility that exists for our shares, such sales could cause the market price of our common stock to decline significantly. In addition, fluctuations in our stock price and our price-to-earnings multiple may have made our stock attractive to momentum, hedge or day-trading investors who often shift funds into and out of stocks rapidly, exacerbating price fluctuations in either direction, particularly when viewed on a quarterly basis.

The trading prices of Internet company stocks in general, including ours, have experienced extreme price and volume fluctuations. To the extent that the public s perception of the prospects of Internet or e-commerce companies is negative, our stock price could decline further, regardless of our results. Other broad market and industry factors may decrease the market price of our common stock, regardless of our operating performance. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations, also may decrease the market price of our common stock. Negative market conditions could adversely affect our ability to raise additional capital.

We are defendants in a number of securities class action litigations. In the past, securities class action litigation often has been brought against a company following periods of volatility in the market price of its securities. To the extent our stock price declines or is volatile, we may in the future be the target of additional litigation. This additional litigation could result in substantial costs and divert management s attention and resources.

Legal Proceedings

We are a party to the legal proceedings described in Note 16 to our Consolidated Financial Statements. The defense of the actions described in Note 16 may increase our expenses and an adverse outcome in any of such actions could have a material adverse effect on our business, results of operations and financial condition.

Regulatory and legal uncertainties could harm our business.

The products and services we offer through the priceline.com service are regulated by federal and state governments. Our ability to provide such products and services is and will continue to be affected by such regulations. The implementation of unfavorable regulations or unfavorable interpretations of existing regulations by courts or regulatory bodies could require us to incur significant compliance costs, cause the development of the affected markets to become impractical and otherwise have a material adverse effect on our business, results of operations and financial condition. See *Uncertainty regarding payment of sales and hotel occupancy and other related taxes*.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We manage our exposure to interest rate risk through internally established policies and procedures and, when deemed appropriate, through the use of derivative financial instruments. We use derivative financial instruments, including an interest rate hedge to manage market risks. Additional information regarding our interest rate hedge is contained within Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Derivative Financial Instruments in our December 31, 2004 Annual Report on Form 10-K.

The objective of our policies is to mitigate potential income statement, cash flow and fair value exposures resulting from possible future adverse fluctuations in interest rates. We evaluate our exposure to market risk by assessing the anticipated near-term and long-term fluctuations in interest rates on a daily basis. This evaluation includes the review of leading market indicators, discussions with financial analysts and investment bankers regarding current and future economic conditions and the review of market projections as to expected future interest rates. We utilize this information to determine our own investment strategies as well as to determine if the use of derivative financial instruments is appropriate to mitigate any potential future interest rate exposure that we may face. Our policy does not allow speculation in derivative instruments for profit or execution of derivative instrument contracts for which there are no underlying exposures. We do not use financial instruments for trading purposes and are not a party to any leveraged derivatives.

We did not experience any material changes in interest rate exposures during the three months ended March 31, 2005. Based upon economic conditions and leading market indicators at March 31, 2005, we do not foresee a significant adverse change in interest rates in the near future.

As of March 31, 2005, after adjusting for the effect of the interest rate swap agreement, we have fixed rate debt of approximately $223.6 million. We estimate that the fair market value of our debt was approximately $206.4 million as of March 31, 2005.

As of March 31, 2005, we held an interest rate swap agreement on $45 million notional value of our fixed rate debt. The fair value (cost if terminated) of this swap as of March 31, 2005 was approximately $1.6 million. A 10% adverse fluctuation in the 3-month LIBOR rate as of March 31, 2005, would decrease the interest rate swap s fair value by approximately $583,000. Any increase or decrease in the fair value of the Company s interest rate sensitive derivative instruments would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying asset, liability, or cash flow.

International net revenues result from transactions by Active Hotels and are typically denominated in British Pounds, the functional currency of Active Hotels. Active Hotels also incurs most of its expenses in British Pounds. Our international operations are subject to risks typical of international business, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility.

Foreign exchange rate fluctuations may adversely impact our financial position as well as our results of operations. Foreign exchange rate fluctuations may adversely impact our financial position as the assets and liabilities of Active Hotels are translated into U.S. dollars in preparing our consolidated balance sheet. Additionally, foreign exchange rate fluctuations may adversely impact our results of operations as exchange rate fluctuations on transactions denominated in currencies other than the U.S. dollar result in gains and losses that are reflected in our consolidated statement of operations. In January 2005, we entered into foreign exchange forward contracts to minimize the short-term foreign currency fluctuations on the operating results of Active Hotels. As of March 31, 2005, contracts with a notional value of approximately 3 million British Pounds were outstanding. We may enter into additional forward contracts or other economic hedges in the future.

Additionally, fixed rate investments are subject to interest rate volatility. To the extent that changes in interest rates and currency exchange rates affect general economic conditions, priceline.com would also be affected by such changes.

Item 4. Controls and Procedures

Prior to filing this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that as of March 31, 2005, our disclosure controls and procedures were effective in timely alerting them to material information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions, and there can be no assurance that any design will succeed in achieving its stated goals.

In addition, we reviewed our internal controls, and, except as further described in the following paragraph, there have been no significant changes in our internal controls or in other factors that could significantly affect those controls to the date of their last evaluation. In the course of this evaluation, we modify and refine our internal processes as conditions warrant.

We are in the process of integrating the operations of Travelweb, control of which we acquired in May 2004. The integration will involve changes in certain systems, processes and internal controls. As we further integrate Travelweb s business, we will continue to review internal controls to ensure that they continue to be effective.

In September 2004, we acquired Active Hotels, and as a result of that acquisition, we have undertaken a review of Active Hotel s internal controls and intend to make changes, if necessary, that we believe to be appropriate to those internal controls as we integrate Active Hotel s business with ours. As we further integrate Active Hotel s business, we will continue to review Active Hotel s internal controls and may take further steps to ensure that its internal controls are effective and integrated appropriately.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

A description of material legal proceedings to which we are a party is contained in Note 16 to the Notes to Unaudited Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.

Item 4. Submission of Matters to a Vote of Security Holders

We held a Special Meeting of Stockholders on January 24, 2005, to vote on an amendment to our 1999 Omnibus Plan (the Plan) increasing the number of shares available under the plan. Below is a description of the matter voted upon and the results of such meeting.

Matter Voted On	For	Against	Abstaining	Broker Non-Votes
Approval of an amendment to the priceline.com Incorporated 1999 Omnibus Plan increasing the number of shares of priceline.com Incorporated common stock with respect to which awards may be granted to 7,895,833 shares from 5,895,833 shares	25,376,102	3,275,484	30,370	

Item 6. Exhibits and Reports on Form 8-K

(a) ***Exhibits***

Exhibit Number	Description
12.1	Calculation of Ratio of Earnings to Fixed Charges and Preferred Dividends.
31.1	Certification of the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) ***Reports on Form 8-K***

On January 5, 2005, we furnished a report on Form 8-K in connection with the resignation of our Chief Operating Officer. On January 26 2005, we furnished a report on Form 8-K in connection with the election of Craig W. Rydin to our Board of Directors. On January 28, 2005, we furnished a report on Form 8-K in connection with, among other things, an amendment to our 1999 Omnibus Plan. On February 7, 2005, we furnished a report on Form 8-K in connection with certain executive employment agreements and restricted stock grants. On February 23, 2005, we furnished a report on Form 8-K in connection with our fourth quarter and year-end 2004 earnings announcement. On March 9, 2005, we furnished a report on Form 8-K in connection with a presentation give by our Chief Executive Officer. On March 28, 2005, we furnished a report on Form 8-K in connection with the launch of our retail-integrated hotel service and related advertising campaign.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRICELINE.COM INCORPORATED
(Registrant)

Date: May 10, 2005

By: /s/ Robert J. Mylod, Jr.
Name: Robert J. Mylod, Jr.
Title: Chief Financial Officer
(On behalf of the Registrant and as principal financial officer)

Exhibit Index

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