EXPEDIA INC
Form 10-Q
May 15, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2003

Commission File Number 0-27429

EXPEDIA, INC.

(Exact name of registrant as specified in its charter)

Washington **(State or other jurisdiction of** **incorporation or organization)**	**91-1996083** **(I.R.S. Employer** **Identification No.)**
13810 SE Eastgate Way, Ste. 400, **Bellevue, WA** **(Address of principal executive office)**	**98005** **(Zip Code)**

Registrant s telephone number, including area code: (425) 564-7200

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes x No ¨

The number of shares outstanding of the registrant s stock as of April 30, 2003 was 119,826,000 consisting of 50,824,000 of common stock and 69,002,000 of Class B common stock.

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EXPEDIA, INC.

FORM 10-Q

For the Quarter Ended March 31, 2003

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PART I. FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

EXPEDIA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002 (restated)
Merchant revenues	$ 116,741	$ 57,650
Agency revenues	77,855	51,741
Advertising and other revenues	4,164	6,615
Revenues	198,760	116,006
Cost of merchant revenues (excluding recognition of stock-based compensation, of $79 and $24 for the three months ended March 31, 2003 and 2002)	30,677	14,793
Cost of agency revenues (excluding recognition of stock-based compensation of $63 and $25 for the three months ended March 31, 2003 and 2002)	24,504	19,503
Cost of advertising and other revenues (excluding recognition of stock-based compensation of $1 and $4 for the three months ended March 31, 2003 and 2002)	533	848
Cost of revenues	55,714	35,144
Gross profit	143,046	80,862
Operating expenses:		
Product development (excluding recognition of stock-based compensation of $560 and $971 for the three months ended March 31, 2003 and 2002)	10,964	8,727
Sales and marketing (excluding recognition of stock-based compensation of $254 and $96 for the three months ended March 31, 2003 and 2002)	62,465	34,836
General and administrative (excluding recognition of stock-based compensation of $6,724 and $486 for the three months ended March 31, 2003 and 2002)	15,499	8,241
Amortization of intangible assets	4,552	8,768
Recognition of stock-based compensation	7,681	1,606
Total operating expenses	101,161	62,178

Income from operations	41,885	18,684
Net interest income and other	2,562	2,683
Share of joint venture net loss	(242)	(247)
USA merger related expense	(2,002)	(9,860)
Income before provision for income taxes	42,203	11,260
Provision for income taxes	(15,337)	(4,614)
Net income	$ 26,866	$ 6,646
Net income per common share:		
Basic	$ 0.23	$ 0.06
Diluted	$ 0.20	$ 0.05
Weighted average number of shares outstanding:		
Basic	118,316	108,558
Diluted	132,028	122,848

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EXPEDIA, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(unaudited)

	March 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 269,641	$ 218,219
Marketable securities	501,806	365,790
Accounts receivable, net of allowance of $2,028 and $1,859, respectively	41,773	35,741
Prepaid merchant bookings	30,505	12,435
Prepaid expenses and other current assets	19,334	12,667
Total current assets	863,059	644,852
Property and equipment, net	30,782	30,368
Restricted deposits and other assets	17,307	15,739
Goodwill, net	124,202	124,286
Intangible assets, net	40,182	44,668
Total assets	$ 1,075,532	$ 859,913
LIABILITIES		
Current liabilities:		
Accounts payable	$ 67,804	$ 39,159
Accrued expenses	206,650	180,628
Deferred merchant bookings	270,202	149,348
Unearned revenue	5,048	4,772
Total current liabilities	549,704	373,907
Commitments and contingencies (Note 8)		
STOCKHOLDERS EQUITY		
Common stock, $.01 par value, 600,000 shares authorized, 50,424 and 48,906 shares issued and outstanding, respectively	505	488
Class B common stock, $.01 par value, 150,000 shares authorized, 69,002 shares issued and outstanding	690	690
Preferred stock, $.01 par value, 20,000 shares authorized, none issued and outstanding		
Stockholder warrants	77,839	77,839
Additional paid-in-capital	534,848	500,839

Contribution from parent	95,443	95,443
Contribution receivable from parent	(59,230)	(62,234)
Unearned stock-based compensation	(550)	(1,564)
Retained deficit	(126,473)	(128,328)
Accumulated other comprehensive income	2,756	2,833
Total stockholders equity	525,828	486,006
Total liabilities and stockholders equity	$ 1,075,532	$ 859,913

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EXPEDIA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Common Stock		Class B Common Stock			Additional		Contribution			Accumulated	
	Shares	Amount	Shares	Amount	Stockholder Warrants	Paid-In Capital	Contribution by Parent	Receivable from Parent	Unearned Stock-Based Compensation	Retained Deficit	Other Comprehensive Income	Total
Balance, December 31, 2002	48,906	$ 488	69,002	$ 690	$ 77,839	$ 500,839	$ 95,443	$ (62,234)	$ (1,564)	$ (128,328)	$ 2,833	$ 486,006
Comprehensive income:												
Net income										26,866		26,866
Unrealized investment gains, net of tax of $78						78					274	352
Less: Reclassification adjustments for gain included in net income, net of tax of $133						(133)					(374)	(507)
Currency translation adjustment											23	23
Total comprehensive income												26,734
Recognition of non-cash marketing expense								3,004				3,004
Proceeds from exercise of options and warrants	2,384	25				12,211				(7)		12,229
Repurchase of common stock	(816)	(8)								(25,004)		(25,012)
Tax benefit from stock options						15,186						15,186
Recognition of stock-based compensation						7,830			(149)			7,681
Forfeiture of stock-based compensation	(50)					(1,163)			1,163			
	50,424	$ 505	69,002	$ 690	$ 77,839	$ 534,848	$ 95,443	$ (59,230)	$ (550)	$ (126,473)	$ 2,756	$ 525,828

Balance, March 31, 2003	

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EXPEDIA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002 (restated)
Operating activities:		
Net income	$ 26,866	$ 6,646
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,075	4,003
Recognition of stock-based compensation	7,681	1,606
Amortization of intangible assets	4,552	8,768
Amortization of discount on marketable securities, net	388	
Realized gain on sale of marketable securities	(374)	
USA merger-related expense	2,002	9,860
Contributed USA marketing expense	3,004	1,488
Provision for deferred income taxes	15,186	4,614
Share of joint venture net loss	242	247
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(6,032)	(6,513)
Prepaid merchant bookings	(18,070)	(5,330)
Prepaid expenses and other current assets	(6,667)	(1,911)
Accounts payable and accrued expenses	54,443	41,552
Deferred merchant bookings	120,854	54,290
Unearned revenue	276	518
Net cash provided by operating activities	209,426	119,838
Investing activities:		
Purchase of marketable securities	(214,662)	
Proceeds from sale of marketable securities	78,477	
Additions to property and equipment	(5,489)	(5,033)
Acquisitions, net of cash acquired		(35,326)
Funding of restricted deposits, net	(1,568)	(2,245)
Net cash used in investing activities	(143,242)	(42,604)
Financing activities:		
USA merger-related expense	(2,002)	(9,860)
Net proceeds from issuance of common stock		48,087
Repurchase of common stock	(25,012)	
Net proceeds from exercise of options and warrants	12,229	11,602
Net cash (used in) provided by financing activities	(14,785)	49,829

Effect of foreign exchange rate changes on cash and cash equivalents	23	(6)
Net increase in cash and cash equivalents	51,422	127,057
Cash and cash equivalents at beginning of period	218,219	238,374
Cash and cash equivalents at end of period	$ 269,641	$ 365,431
Supplemental disclosures to cash flow statements:		
Contribution from parent non-cash prepaid marketing expenses		$ 75,000
Contributed USA marketing expense	$ 3,004	1,488
Forfeiture of stock-based compensation	1,163	11
Acquisition of new businesses		48,611
Issuance of warrants to stockholders		77,869
Cash paid for interest		1
Issuance of restricted stock		1,908

EXPEDIA, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business

Expedia, Inc. (the Company or Expedia) sells travel services to leisure and corporate customers around the world. This encompasses providing schedule, pricing and availability information for booking reservations for airlines, hotels, rental cars, cruises and other travel products such as sightseeing tours, show and event tickets and theme park passes. The Company sells these travel services both individually and as components of dynamically-assembled packaged travel vacations and trips. In addition, the Company provides content that presents travelers with information about travel destinations, maps and other travel details.

The Company sells these travel services through five different distribution channels. The primary distribution channel is through its own websites. These websites are located at Expedia.com, Expedia.co.uk, Expedia.de, Expedia.ca, Expedia.it and Expedia.nl. The Expedia-branded websites also serve as the travel channel on MSN.com, Microsoft s online services network. Visitors can also connect to the Expedia-branded websites via links from other websites.

The second distribution channel the Company sells through is directly on other travel companies websites. The Company does this through Worldwide Travel Exchange (WWTE), the private label travel business of one of its subsidiaries. A third distribution channel is selling travel services to customers through a toll-free telephone number designed to assist customers with complex or high-priced offerings. The fourth distribution channel the Company sells through is a network of third-party travel agents and travel agencies. The fifth distribution channel is through the Company s own travel agents for its corporate travel business. The Company s travel agents work both in the Company s offices and onsite at various corporate customer locations.

The Company classifies revenues into three categories: merchant, agency, and advertising and other. Merchant revenues are derived from travel related sales transactions where the Company both purchases from the supplier and sells to the customer the requested travel service. Merchant revenues are presented in the statement of operations at the net amount, which reflects the gross amount charged to the customer less the cost paid to the supplier. Agency revenues are derived from travel-related sales transactions where the Company receives commissions and fees from travel suppliers and customers. Agency revenues also include paper ticket mailing fee revenues, which are generated by processing and delivering a paper ticket via express mail if the customer chooses not to have an electronic ticket or an electronic ticket is not available, and service fees which are charged to customers for most airline tickets booked on the Company s U.S. and Canadian websites. Advertising and other revenues consist primarily of advertising revenues. The Company derives advertising revenues from advertisements on its websites. The Company has also licensed components of its technology to other companies.

The Company was incorporated in the state of Washington on August 23, 1999. Prior to that, it operated as a separate business within Microsoft Corporation (Microsoft). It began selling travel services on its first website, Expedia.com, in October 1996. On October 1, 1999, Microsoft separated the Company s assets and contributed them in exchange for 66,000,000 shares of Expedia common stock or 100% of the outstanding common stock at that date. On November 10, 1999, the Company completed an initial public offering in which it sold 11,960,000 shares of common stock at a price of $7.00 per share, raising $76.6 million in net proceeds. On February 4, 2002, USA Interactive (formerly known as USA Networks, Inc.) (USA) completed its acquisition of a controlling interest in Expedia, including all of Microsoft s shares, through a subsidiary merger (the USA acquisition of control). On March 19, 2003, the Company announced that it entered into a merger agreement with USA whereby USA would acquire all of the Company s publicly held shares it did not currently own in a stock-for-stock merger. Upon completion of the merger, Expedia will be a wholly-owned subsidiary of USA. See Note 3.

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2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated balance sheets and related interim condensed consolidated statements of operations, cash flows and changes in stockholder s equity and comprehensive income, are unaudited and in the opinion of management, include all adjustments (consisting only of normal recurring items) necessary for their fair presentation in conformity with accounting principles generally accepted in the U.S. Preparing financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from those estimates. Interim results are not necessarily indicative of results for a full year. Readers of the condensed consolidated financial statements should read the information included in this Form 10-Q in conjunction with Management s Discussion and Analysis and consolidated financial statements and notes included in the Company s report on Form 10-K/A for the year ended December 31, 2002 filed with the Securities and Exchange Commission on April 30, 2003.

Intangible Assets and Goodwill

Statements of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, prescribes a two-phase process for impairment testing of goodwill, which is performed once annually, absent indicators of impairment. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. The Company has elected to perform the annual impairment test during the fourth calendar quarter of each year. No indicators of impairment were identified during the first quarter of 2003.

Amortization expense for acquired intangible assets for the three months ended March 31, 2003 and 2002, was $4.5 million and $8.8 million, respectively. The estimated amortization for the remaining nine months ended December 31, 2003, is $8.5 million.

The annual estimated amortization expense for the acquired intangible assets for the next five years ending December 31 is as follows (in thousands):

2004	$5,809
2005	3,767
2006	3,676
2007	3,150
2008	1,240

Stock Split in the Form of a Stock Dividend

On February 5, 2003, the Company announced that its Board of Directors had approved a two-for-one stock split in the form of a stock dividend, payable to shareholders of record as of February 24, 2003. References to the number of shares, options and warrants, income per share and other per share amounts in these condensed consolidated financial statements have been adjusted to reflect the split. The stock split was effective on

March 10, 2003.

Stock-Based Compensation

Effective January 1, 2003, the Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, and SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. Under SFAS No. 148, the Company has elected to apply the fair value recognition approach of SFAS No. 123 on a prospective basis. As a result, the Company has expensed all employee awards granted, modified or settled after January 1, 2003. For employee stock-based compensation awards granted prior to January 1, 2003, the Company accounted for the awards under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations.

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The Company s stock-based compensation awards include both non-qualified stock options and restricted stock units. Under SFAS No. 123, these awards are valued at the grant date using the Black-Scholes valuation model and compensation cost is recognized ratably over the vesting period. To the extent awards are forfeited prior to vesting, the corresponding previously-recognized expense is reversed in the period of forfeiture.

The following assumptions are used in the valuation of stock-based compensation:

	Three Months Ended March 31,	
	2003	**2002**
Average risk-free interest rates	2.76%	3.84%
Average expected life (in years)	4.5	5
Volatility	50%	55%

The following table illustrates the results of operations that would have been reported if the fair value based method had been applied to all stock awards granted since the Company s inception (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2003	**2002**
Net income, as reported	$ 26,866	$ 6,646
Add: Stock-based compensation expense included in reported net income, net of related tax effects	4,954	1,568
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(12,960)	(9,265)
Pro forma net income (loss)	$ 18,860	$ (1,051)
Net income (loss) per common share:		
Basic as reported	$ 0.23	$ 0.06
Basic pro forma	$ 0.16	$ (0.01)
Diluted as reported	$ 0.20	$ 0.05
Diluted pro forma	$ 0.14	$ (0.01)
Weighted average number of shares outstanding:		

Basic	118,316	108,558
Diluted	132,028	122,848

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. The Interpretation is to be adopted for financial statements for the fiscal year or interim period beginning after June 15, 2003. This Interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, and requires consolidation of the results of variable interest entities in which an entity has a majority variable interest. The Company does not expect the adoption of the Interpretation to have a material effect on its financial position or results of operations.

3. USA Merger

On March 19, 2003, the Company announced that it entered into a merger agreement with USA whereby USA would acquire all the Company s publicly held shares it did not currently own in a stock-for-stock merger. The Expedia Board of Directors approved the agreement following the unanimous recommendation and approval

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of a disinterested Special Committee of the Expedia Board. Under the agreement, Expedia shareholders will receive 1.93875 shares of USA common stock for each share of Expedia stock that they own. In connection with the merger, Expedia warrants and options will be converted into warrants and options to acquire USA common stock. The parties expect that the transaction will generally be tax-free to Expedia shareholders. The merger is subject to certain conditions to closing contained in the merger agreement, which was filed with the SEC on March 19, 2003.

4. Classic Custom Vacations Acquisition

On March 9, 2002, the Company acquired substantially all of the assets of CCV, a wholly-owned subsidiary of Classic Vacation Group, Inc. (CVG), a publicly traded corporation, for an aggregate purchase price of approximately $48.6 million, plus the assumption of approximately $30 million in net liabilities. The Company has accounted for this transaction under the purchase method of accounting in accordance with SFAS No. 141, Business Combinations.

The following table summarizes the purchase accounting for the acquisition (in thousands):

Current and long-term assets	$ 48,925
Intangibles and goodwill	78,715
Liabilities assumed	(78,533)
Net assets acquired	49,107
Less: acquisition costs	(496)
Purchase price	$ 48,611

The following table presents the results of operations of the Company for the three months ended March 31, 2002 on a pro forma basis. These results are based on the individual historic results of the Company and CCV and reflect adjustments to give effect to the acquisition as if they had occurred at the beginning of the period presented (in thousands):

	Three Months Ended March 31, 2002
Revenues	$ 131,863
Cost of revenues	46,997
Gross profit	84,866
Operating expenses	66,504
Income from operations	18,362
Other expense	(7,125)
Income before provision for income taxes	11,237

Provision for income taxes		(4,638)
Net income	$	6,599
Net income per common share:		
Basic	$	0.06
Diluted	$	0.05
Weighted average number of shares outstanding:		
Basic		109,620
Diluted		123,910

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5. Income Tax

Effective October 1, 1999, the Company entered into a tax allocation agreement with Microsoft. On March 18, 2000, Microsoft s investment in the Company fell below 80 percent ownership and as a result, the Company began filing separate tax returns. Based on the tax allocation agreement, the Company may be reimbursed by Microsoft for tax losses incurred during the period from October 1, 1999, to March 17, 2000, that are utilized on the Microsoft consolidated U.S. federal tax return. Reimbursements of approximately $2.5 million are expected to be received from Microsoft under this agreement when Microsoft utilizes the Company s tax losses. As of March 31, 2003, the Company has received $0.1 million of reimbursement from Microsoft, which was recorded as a capital contribution.

Under the tax allocation agreement, the Company must pay Microsoft for a portion of the tax savings resulting from the exercise of certain stock options. In November 2001, the Company entered into an agreement with Microsoft setting forth the manner in which the Company will compensate Microsoft for these tax savings. Under the November 2001 agreement, the Company generally will be required to indemnify Microsoft for the actual federal and state tax savings, up to approximately $36 million that the Company may realize as a result of the use of certain compensation deductions, if and when the Company utilizes such tax savings. As of March 31, 2003, the Company has not utilized the tax savings. Any compensation to Microsoft as a result of utilized tax savings will be recorded as a capital distribution.

At March 31, 2003, the Company has net operating loss carryforwards of approximately $293 million for federal income tax purposes. The net operating loss carryforwards begin to expire in 2017. Approximately $31 million of the loss carryforwards are from acquired companies, the utilization of which, in each carryforward year, may be limited by the Internal Revenue Code.

At March 31, 2003, the Company has utilized the benefit of all of its net operating loss carryforwards other than those generated by stock compensation tax deductions. The remaining net operating loss carryforwards will be utilized to reduce income taxes payable. The benefit of the remaining net operating losses will be recorded as an increase to additional paid-in capital, when realized.

Based upon the Company s limited operating history, the difficulty in accurately forecasting long-term future results, the large amount of net operating loss carryforwards for income tax purposes and the expected continuation of tax deductions attributable to stock option deductions, the Company has applied a valuation allowance equivalent to the expected tax benefit from its net operating loss carryforward and other deferred tax assets. As a result, the Company has not recorded a benefit for current federal and state income taxes or a related deferred tax asset.

6. Net Income Per Share

Net income per share has been computed in accordance with SFAS No. 128, Earnings Per Share. Net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding.

7. Related Party Transactions

Microsoft

Subsequent to October 1, 1999, the Company had entered into a number of agreements with Microsoft to facilitate the operations of the Company. Through February 4, 2002, when Microsoft ceased being a related party, the Company recorded revenues and incurred costs representing charges from these agreements as follows (in thousands):

	Three Months Ended March 31, 2002
Cost of revenues	$ (355)
Product development	(422)
Sales and marketing	(944)
General and administrative	(129)
Net expense	$ (1,850)

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USA

In connection with the USA acquisition of control consummated on February 4, 2002, the Company received the right to advertising, marketing and promotion time, valued at $15 million for each of the five years after the consummation date, on the various media outlets related to USA. The total amount due under this arrangement was recorded as contribution receivable from parent within the consolidated statement of changes in stockholders equity and comprehensive income. During the three months ended March 31, 2003 and 2002, the Company recorded $3.0 million and $1.5 million, respectively, under this arrangement as sales and marketing expense.

On March 19, 2003, Expedia and USA announced that they entered into a merger agreement by which USA would acquire the Expedia shares it does not currently own in a stock-for-stock merger. Our Board of Directors approved the agreement following the unanimous recommendation and approval of a disinterested Special Committee of our Board. Under the agreement, Expedia shareholders will receive 1.93875 shares of USA common stock for each share of Expedia stock that they own. In connection with the merger, Expedia warrants and options will be converted into warrants and options to acquire USA common stock. The parties expect that the transaction will generally be tax-free to Expedia shareholders. The merger is subject to certain conditions to closing contained in the merger agreement, which was filed with the SEC on March 19, 2003.

Ticketmaster

The Company entered into an agreement with Ticketmaster, Inc. (Ticketmaster), a subsidiary of USA, on March 19, 2002, to create a new gateway channel on Citysearch.com s website. This is a content area that provides site visitors with Citysearch s local content and enables them to plan and book trips using an Expedia.com booking tool with the availability of some Ticketmaster event tickets within Expedia s customer-built trips. Revenues generated through the gateway channel are shared based on an agreed-upon transaction fee paid by the Company to Ticketmaster. The transaction fees paid in connection with this agreement during the three months ended March 31, 2003 and 2002 were $0.1 million and $0, respectively.

Hotels.com

As the Company and Hotels.com have a common controlling shareholder, the Company previously has said that it would explore areas where it might work together with Hotels.com in a way that would benefit all Expedia customers and stockholders. Although there continues to be many areas of its business where the Company has decided that it can best achieve its goals through separate strategies and practices, there have been instances where, fully consistent with its existing contractual agreements, it has worked cooperatively with Hotels.com, and it anticipates that it will continue to explore such possibilities in the future. On April 10, 2003, USA announced that that they had entered into an agreement with Hotels.com by which USA, already the majority owner of Hotels.com, would acquire the Hotels.com shares it does not currently own in a tax-free, stock-for-stock transaction.

8. Commitments and Contingencies

The Company has multi-year agreements with certain travel service providers that make available the services accessed through the Company s website. Under these agreements, the Company pays monthly service fees to the service providers based on the volume of activity. The Company expenses these amounts as the services are provided. None of the transactions involves any payment or discount to the customer.

The Company will incur an additional $5.0 million of expense related to financial advisory fees in conjunction with USA s proposal in March 2003 a merger whereby USA would seek to acquire all of the Company s publicly held shares. The expenditure is contingent upon consummation of the merger and will be recorded upon consummation.

Between June 5 and July 26, 2001, four class action complaints, alleging violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20 of the Securities Exchange Act of 1934, were filed in the United States District Court for the Southern District of New York against the Company, certain of its officers and directors and certain underwriters of the Company s initial public offering (IPO). On August 9, 2001, these actions were consolidated before a single judge along with cases brought against numerous other issuers and their underwriters that make similar allegations involving the IPOs of those issuers. The consolidation was for purposes of pretrial motions and discovery only. Plaintiffs filed an amended complaint on April 20, 2002. The amended complaint alleges that the Company s prospectus was false or misleading in that it failed to disclose (i) that the underwriters allegedly were paid excessive commissions by certain customers in return for receiving shares in the IPO and (ii) that certain of the underwriters customers allegedly agreed to purchase additional shares of the Company in the aftermarket in return for an allocation of shares in the IPO. The complaint further alleges an agreement by the underwriters with the Company to provide positive market analyst coverage for the Company after the IPO that had the effect of manipulating the market for Expedia s stock. Plaintiffs contend that, as a result of the alleged omissions from the prospectus and alleged market manipulation through the use of analysts, the price of the Company s stock was artificially inflated between November 9, 1999 and December 6, 2000, and that the defendants are liable for unspecified damages to those persons who purchased stock during that period. On July 15, 2002, the Company and the individual defendants, along with the other issuers and their related officer and director defendants, filed a joint motion to dismiss based on common issues. Arguments for and against the motion to dismiss were presented to the court on November 1, 2002. The court denied the Company s motion on February 19, 2003. Discovery is currently ongoing. The Company intends to vigorously defend against this action.

On September 6, 2002, a complaint was filed with the Superior Court of the State of Washington for King County by Amazon.com Commerce Services, Inc. alleging that the Company breached a May 25, 2001 Linking Agreement between Expedia and Amazon. Amazon alleges that the Company breached the Linking Agreement by failing to make payments due. Amazon also alleges that the Company refused to pay the amounts owed unless Amazon renegotiated the Linking Agreement and despite Amazon s willingness and ability to continue performing its obligations, and that as a result, the Company is in breach of the duty of good faith and fair dealing implied in every contract. Amazon s complaint seeks a judgment of approximately $3.7 million, plus prejudgment interest, an award of attorneys fees and other unspecified damages. On March 3, 2003, the Company answered Amazon s complaint, denied its claims and asserted affirmative defenses. The Company also alleged that Amazon failed to perform under the Linking Agreement and asserted counterclaims for (1) breach of contract, (2) breach of the duty of good faith and fair dealing, (3) violation of the Washington Consumer Protection Act, and (4) declaratory relief. The Company is claiming damages in an amount to be determined at trial, and additionally is seeking attorneys fees and costs and a declaration from the court that Amazon is in material breach of the Linking Agreement and that the Company has the right to terminate the term of the Linking Agreement and/or to rescind the Linking Agreement. The court s case schedule, issued upon filing of the complaint, sets a trial date of February 2, 2004. Discovery is currently ongoing. The Company intends to vigorously defend against Amazon s claims and prosecute the Company s counterclaims.

Following USA s announcement on June 3, 2002 that it intended to commence an exchange offer to acquire up to 100% of the outstanding shares of Expedia that it did not already own, putative class action complaints against USA, Expedia, and members of the Expedia board of directors were filed by individual shareholders of Expedia in King County Superior Court in the State of Washington. The complaints generally alleged that consummation of the exchange offer would be a breach of fiduciary duty and that the indicated exchange ratio was unfair to the minority shareholders of Expedia. Each of the complaints sought, among other things, injunctive relief against consummation of the exchange offer, damages in an unspecified amount and rescission in the event the exchange offer occurred.

In July 2002, the actions were consolidated, and orders were entered providing that the defendants need not respond to the complaint until after the announcement of a transaction contemplating the purchase by USA of the shares of Expedia that it did not already own. The consolidated action was dismissed without prejudice on November 22, 2002.

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On March 20, 2003, one day after the public announcement that USA and Expedia had entered into a definitive merger agreement, the plaintiffs in the consolidated action filed a purported notice of reinstatement of their claims. On March 20, 2003, three additional purported class actions on behalf of Expedia shareholders were filed in King County Superior Court against Expedia, USA, and members of the board of directors of Expedia. Additional purported class action complaints were filed on March 24, 2003 and April 2, 2003. These recent complaints allege, in essence, that the defendants breached their fiduciary duties to Expedia s public shareholders by entering into and/or approving the merger agreement, which allegedly does not reflect the true value of Expedia. The complaints seek to enjoin consummation of the transaction or, in the alternative, to rescind the transaction, as well as damages in an unspecified amount. On April 22, 2003, the Washington court entered an Order formally reinstating the consolidated action. On May 5, 2003, upon the stipulation of all parties, the court consolidated the five recently filed class actions into the consolidated action.

The Company is currently conducting an on-going review and interpretation of the tax laws in various state and local jurisdictions surrounding state and local sales and hotel occupancy taxes. The current business practice is that the hotels collect and remit these taxes to the various tax authorities based on the amounts collected by the hotels. Consistent with this practice, the Company recovers the taxes from customers and remits the taxes to the hotel operators for payment to the appropriate tax authorities. Several jurisdictions have stated that they may take the position that the tax is also applicable to the Company s gross profit on merchant hotel transactions and one of them has contacted the Company regarding whether hotel occupancy taxes should be remitted on the Company s revenues from its merchant hotel transactions. The Company has not paid nor agreed to pay such taxes but has a reserve for potential payment. An unfavorable outcome of some of all of these matters could have a substantial impact on the Company s financial position, liquidity, and results of operations.

In addition to the matters discussed above, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. Management believes that the resolution of all such matters will not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

9. Stock repurchase

On February 5, 2003, the Company publicly announced that its Board of Directors had approved the repurchase of up to $200 million of the Company s stock. As of March 31, 2003, the Company repurchased approximately 816,000 shares in the amount of $25.0 million of common stock pursuant to this program at prices ranging from $29.68 to $31.47 per share. The Company recorded the repurchase of the common stock as a charge to retained deficit.

10. Segment Information

As of April 1, 2002, the Company changed its reportable segments to two, North America and International, to reflect a restructuring of its organization. The segment information relating to the three-month period ended March 31, 2002 has been restated to reflect the change in reportable segments. The North America segment generates its revenues from its points-of-sale in the U.S. and Canada. The International segment generates its revenues from its points-of-sale in the U.K., Germany, Belgium, Italy, the Netherlands and France.

Segment information is presented in accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. SFAS No. 131 is based on a management approach, which requires segmentation based upon the Company s internal organization and disclosures of revenue and operating loss based upon internal accounting methods.

Management evaluates each segment s performance based upon income or loss from operations. This involves significant allocations of various corporate and overhead expenses across the segments. These allocations are primarily based on transaction volumes and other metrics.

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The segment information is as follows (in thousands):

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Revenues		
North America	$ 182,410	$ 109,437
International	16,350	6,569
Total	$ 198,760	$ 116,006
Depreciation and amortization		
North America	$ 9,468	$ 12,699
International	159	72
Total	$ 9,627	$ 12,771
Income (loss) from operations		
North America	$ 41,135	$ 20,517
International	750	(1,833)
Total	$ 41,885	$ 18,684

Assets of the segments are not relevant for management of the business. Depreciation expense has been allocated to the two segments based on a usage metric. Amortization of goodwill and intangibles exclusively relates to the North America segment. There are no reconciling items between the segment information indicated above to the consolidated statements of operations, nor are there any inter-segment revenues.

The Company has allocated revenues from external customers to geographic areas by selling location. The North America segment derives revenues from the Company s U.S. and Canadian websites and other operations and the International segment derives revenues from the Company s international websites.

11. Restatement

In April 2003, the Company became aware of an error in the computation of amortization of stock-based compensation expense for the year ended June 30, 2000, related to stock options granted on the completion of its initial public offering in place of the cancelled unvested Microsoft options. Subsequent periods (year ended June 30, 2001, six-month period ended December 31, 2001, and the year ended December 31, 2002) were also affected by the impact of the error. As a result of the error, the Company revised the consolidated financial statements, including the notes to consolidated financial statements in the Form 10-K/A which was filed April 30, 2003.

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The effect of the restatement for the three months ended March 31, 2002, is as follows (in thousands, except per share amounts):

	Three Months Ended March 31, 2002
Recognition of stock-based compensation:	
As previously reported	$ 2,537
Restated	$ 1,606
Net income:	
As previously reported	$ 5,715
Restated	$ 6,646
Net income per common basic share:	
As previously reported	$ 0.05
Restated	$ 0.06
Net income per common diluted share:	
As previously reported	$ 0.05
Restated	$ 0.05

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

RESULTS OF OPERATIONS

The information contained in this section has been derived from our consolidated financial statements and should be read together with our consolidated financial statements and related notes included elsewhere in this 10-Q.

As discussed in Note 11 in the notes to the consolidated financial statements, Expedia has restated its consolidated financial statements. The following discussion has been revised to reflect the results of such restatement. The discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those expressed or implied in these forward-looking statements as a result of various factors, including those set forth at the end of this section under Factors That May Impact Our Results of Operations .

Critical Accounting Policies and Judgments

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company s most critical accounting policies as the ones that are most important to the portrayal of the company s financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions. See Note 2 Summary of Significant Accounting Policies in our audited consolidated financial statements of our Report on Form 10-K/A for the year ended December 31, 2002. Although we believe that our estimates and assumptions are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions or conditions.

Revenue Recognition

We generally recognize revenue from product sales or services rendered when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable and collectibility is reasonably assured.

Merchant revenues are derived from transactions where we are the merchant of record and determine the price to the customer. We have agreements with suppliers for inventory (e.g., air tickets or hotel rooms) that we sell. We do not have purchase obligations for unsold inventory. We present merchant revenues in accordance with Emerging Issues Task Force (EITF) Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. Based upon our evaluation of our merchant transactions and in accordance with the various indicators identified in EITF No. 99-19, we determined our suppliers assume the majority of the business risks which include providing the service and the risk of unsold inventory. As such, all merchant transactions are recorded at the net amount, which is the amount charged to the customer less the amount to be paid to the supplier. Recognition of merchant revenue occurs on the date of the traveler s usage.

We accrue for costs of merchant revenues based on the expected amount to be invoiced to us by our suppliers. If we do not receive an invoice within a certain period of time, typically within six months, or the invoice is less than the accrued amount, we may reverse a portion of the accrued cost, thus, increasing net revenue, after giving consideration to the applicable state escheat laws. We determine the amounts to be reversed into revenues based on our understanding of the escheat laws, our estimates of billings suppliers will send us after six months following the travel date, and our analysis of reasons underlying the unbilled amounts. If our judgments regarding these factors were inaccurate, actual revenues could differ from the amount we recognize, directly impacting our results of operations.

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For our merchant air business, the cost of the airline ticket is paid by us to the airlines via the Airlines Reporting Corporation within a week after the customer purchases the ticket from us. This cost to us is treated as prepaid merchant bookings on the consolidated balance sheet until the flight occurs, when it is then applied against the customer purchase in order to record revenue on a net basis. Cash paid by the customer at the time the reservation is booked for merchant transactions is treated as deferred merchant bookings on the consolidated balance sheet until usage occurs, when it is then applied against the cost in order to record revenue on a net basis.

We are currently conducting an on-going review and interpretation of the tax laws in various states and jurisdictions relating to state and local sales and hotel occupancy taxes. We are also monitoring the effect of value added taxes in certain foreign jurisdictions in which we operate. The current business practice is that the hotels collect and remit these taxes to the various tax authorities based on the amounts collected by the hotels. Consistent with this practice, we recover the taxes from customers and remit the taxes to the hotel operators for payment to the appropriate tax authorities. Several jurisdictions have stated that they may take the position that the tax is also applicable to our gross profit on merchant hotel transactions. We have not paid nor agreed to pay such taxes but have a reserve for potential payment. We evaluate our risks on a quarterly basis and, based on our assessment, we adjust the reserve and revenue accordingly.

Agency revenues are derived from airline ticket transactions, hotel, cruise, car rental reservations and service fees. We recognize agency revenues on airline ticket transactions when the reservation is made and secured by a credit card. Our revenues from reservation fees are subject to forfeiture in the event of a ticket cancellation. No revenue reserve for cancellations was required prior to June 2002, as airlines paid a separate cancellation fee, higher than the reservation fee cancelled, to agents upon cancellation. However, beginning June 2002, airlines eliminated payment of a cancellation fee to agents such as Expedia. Accordingly, beginning on that date we have been recognizing a cancellation allowance on these revenues based on historical cancellation experience. We recognize agency revenues on hotel, cruise and car rental reservations at the earlier of notification of the amount of the commission from a commission clearinghouse or an individual supplier or on receipt of the commissions. Override commissions are recognized each period based upon the projected and actual attainment of predetermined target sales levels. Where historical financial data is not available to project the target sales levels, we record the override commission upon receipt of the commission from the supplier. We recognize service fees as the services are performed and completed.

Advertising revenues are derived from the sales of advertisements on our websites. We generally recognize advertising revenues ratably over the advertising period, depending on the terms of the advertising contract. We also recognize some revenue relating to barter arrangements. The Company has applied EITF 99-17, Accounting for Advertising Barter Transactions, in the valuation and recognition of this revenue. Fees from the licensing of software are another source of revenues. The fixed portion of these license fees are recognized ratably over the lives of the contracts upon delivery of the software. Transaction-based fees are recognized when the relevant transactions occur. We have applied Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, With Respect to Certain Transactions, in the valuation of this revenue.

Non-Application of Push Down Basis of Accounting

Under the SEC rules, financial statements filed with the SEC of companies following a more than 95% change in ownership have to be restated to reflect the purchaser s push down basis of accounting. Push-down is not allowed in the event of a less than 70% change in control. If 70% or more, but no more than 95% change in control occurred, application of the push-down basis is at the company s discretion. Because USA acquired more than 70%, but less than 95% of Expedia s shares and voting power, Expedia had the choice of whether to apply push-down basis of accounting, and has elected not to do so. If push-down basis were applied, all of Expedia s assets and liabilities as of the date of its acquisition by USA would have been restated to fair values; and retained deficit and other equity accounts as of the acquisition date would have been eliminated.

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Capitalized Internal Use Software and Website Development Costs

We capitalize certain direct costs incurred in conjunction with developing internal use software in accordance with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. These costs are being amortized using the straight-line method over their estimated useful lives ranging from three to five years, beginning when the software is ready for use. We also capitalize website development costs in connection with the periodic upgrades to our websites in accordance with EITF 00-2, Accounting for Website Development Costs. These costs are being amortized using the straight-line method over a one-year estimated useful life, beginning with the release of the website enhancements to which these costs pertained. Internal use software and website development costs are included in property and equipment assets in the accompanying consolidated balance sheets. The determination of estimated useful lives is sensitive to estimates used. Accordingly, any changes in estimates could have a material impact on the resulting fair values and thus the assessment of impairment.

Stock-Based Compensation

Effective January 1, 2003, the Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Under SFAS No. 148, the Company has elected to apply the fair value recognition approach of SFAS No. 123 on a prospective basis. As a result, the Company has expensed all employee awards granted, modified or settled after January 1, 2003. For employee stock-based compensation awards granted prior to January 1, 2003, the Company accounted for the awards under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations.

The Company s stock-based compensation awards include both non-qualified stock options and restricted stock units. Under SFAS No. 123, these awards are valued at the grant date using the Black-Scholes valuation model and compensation cost is recognized ratably over the vesting period. To the extent awards are forfeited prior to vesting, the corresponding previously recognized expense is reversed in the period of forfeiture.

Income Taxes

We account for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance to reduce deferred tax assets to their estimated realizable value.

As of March 31, 2002, we had utilized the benefit of all of our net operating loss carryforwards that had been generated through our operations. The remaining net operating loss carryforwards, which are attributable to acquired net operating losses and stock option deductions, will be utilized to reduce income taxes payable. The benefit of the remaining net operating losses will be recorded as an increase to additional paid-in capital, when realized.

Based on our limited operating history, the difficulty in accurately forecasting long-term future results, the large amount of net operating loss carryforwards for income tax purposes and the expected continuation of tax deductions attributable to stock option exercises, we have applied a valuation allowance equivalent to the expected tax benefit from our net operating loss carryforward and other deferred tax assets. As a result, we have not recorded a benefit for current federal and state income taxes or a related deferred tax asset.

A valuation allowance against deferred tax assets is recorded if it is more likely than not that existing deferred tax assets will not be realized as defined under SFAS No. 109, Accounting for Income Taxes. Such determination includes estimates of expected taxable income and the timing of the reversal of deferred tax liabilities. In the event that actual results differ materially from management s expectations, the valuation allowance could materially change, directly impacting our financial position and results of operations.

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Recent Developments

On March 19, 2003, the Company announced that it entered into a merger agreement with USA whereby USA would acquire all the Company s publicly held shares it did not currently own in a stock-for-stock merger. The Expedia Board of Directors approved the agreement following the unanimous recommendation and approval of a disinterested Special Committee of the Expedia Board. Under the agreement, Expedia shareholders will receive 1.93875 shares of USA common stock for each share of Expedia stock that they own. In connection with the merger, Expedia warrants and options will be converted into warrants and options to acquire USA common stock. The parties expect that the transaction will generally be tax-free to Expedia shareholders. The merger is subject to certain conditions to closing contained in the merger agreement, which was filed with the SEC on March 19, 2003.

Results of Operations

The following table sets forth our results of operations as a percentage of revenues.

	Three Months Ended March 31,	
	2003	**2002 (restated)**
Statement of Operations Data:		
Merchant revenues	59%	50%
Agency revenues	39%	44%
Advertising and other revenues	2%	6%
Revenues	100%	100%
Cost of merchant revenues	15%	13%
Cost of agency revenues	12%	16%
Cost of advertising and other revenues	0%	1%
Cost of revenues	27%	30%
Gross profit	73%	70%
Operating expenses:		
Product development	6%	8%
Sales and marketing	31%	30%
General and administrative	8%	7%
Amortization of intangible assets	2%	8%
Recognition of stock-based compensation	4%	1%

Total operating expenses	51%	54%
Income from operations	22%	16%
Net interest income and other	1%	2%
Share of joint venture net loss	0%	0%
USA merger-related expense	-1%	-8%
Income before provision for income taxes	22%	10%
Provision for income taxes	-8%	-4%
Net income	14%	6%

Revenues

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
Merchant revenues	$ 116,741	$ 57,650	102%
Agency revenues	77,855	51,741	50%
Advertising and other revenues	4,164	6,615	-37%
Revenues	$ 198,760	$ 116,006	71%

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Total revenues for the three months ended March 31, 2003 and 2002 were $198.8 million and $116.0 million, respectively, an increase of 71%. Excluding the acquisitions of Classic Custom Vacations (CCV) and Metropolitan, total revenues for the three months ended March 31, 2003 and 2002 would have been $181.7 million and $110.4 million, an increase of 65%. The increase was primarily attributable to the growth in our worldwide merchant hotel business, which has been driven by: our strong packages business; our fast-growing international business; and the expansion and acceptance of our WWTE product. The increase in revenues was slightly impacted by the effects on the travel industry surrounding the war in Iraq and terrorist activities.

Merchant revenues for the three months ended March 31, 2003 and 2002 were $116.7 million and $57.7 million, respectively, an increase of $59.0 million or 102%. Merchant revenues increased due to an increase in the number of room nights stayed coupled with a higher average daily room rate. The rate improvement is due primarily to a shift in mix to higher priced destinations such as Europe, Hawaii, Mexico and the Caribbean. The volume increase is attributable to the continued growth in traffic to our websites along with our focus on giving customers the flexibility to purchase merchant hotel rooms as a stand-alone product or combined with other travel products in a package. In addition, revenues related to CCV, our provider of luxury vacation packages to Mexico, North America, Europe and the Caribbean through a network of travel agents and travel agencies, increased by $9.2 million. The quarter ended March 31, 2002 only included results of CCV s operations from the acquisition date of March 9, 2002 onward. All components of CCV s vacation packages are classified as merchant revenues.

Agency revenues for the three months ended March 31, 2003 and 2002 were $77.9 million and $51.7 million, respectively, an increase of $26.2 million or 50%. Agency revenues increased primarily due to an increase in airline ticket transactions and, to a lesser extent, an increase in revenue per ticket. The newly-implemented airline ticket service fee has offset both a trend towards reduced commissions paid by airlines and greater acceptance of e-tickets which has reduced our paper ticket mailing fees. Revenue growth also reflects our acquisition of Metropolitan in July of 2002 and the launch of our Expedia Corporate Travel product in November of 2002 .

Advertising and other revenues for the three months ended March 31, 2003 and 2002 were $4.2 million and $6.6 million, respectively, a decrease of $2.4 million or 37%. The decrease is primarily due to a license agreement expiring in the quarter ended September 30, 2002.

Cost of Revenues and Gross Profit

	Three Months Ended March 31,		
	2003	**2002**	**% Change**
	($ in thousands)		
Cost of merchant revenues	$ 30,677	$ 14,793	107%
Cost of agency revenues	24,504	19,503	26%
Cost of advertising and other revenues	533	848	-37%
Cost of revenues	$ 55,714	$ 35,144	59%
% of revenues	27%	30%	
Gross profit	$ 143,046	$ 80,862	77%

% of revenues	73%	70%

Costs of merchant revenues consist of credit card merchant fees and allocated and direct costs for the operation of our data center and call centers. The costs of agency revenues consist primarily of fees paid to our fulfillment vendors for issuing airline tickets and related customer services, reserves and related payments to the airlines for tickets purchased with fraudulent credit cards, fees paid to our global distribution partners for use of

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their computer reservation and information services systems and allocated and direct costs for the operation of our data center and call centers. The costs of advertising and other revenues consist mainly of costs related to the employees who are responsible for placing banners and other advertisements on our websites.

Cost of revenues for the three months ended March 31, 2003 and 2002 were $55.7 million and $35.1 million, respectively, an increase of $20.6 million or 59%. Gross profit for the three months ended March 31, 2003 and 2002 were $143.0 million and $80.9 million, respectively, an increase of $62.1 million or 77%. Gross margin for the three months ended March 31, 2003 and 2002 was 73% and 70%. Excluding CCV and Metropolitan for the three months ended March 31, 2003 and 2002, cost of revenues would have been $41.6 million and $31.2 million, respectively, an increase of $10.4 million or 33%; gross profit would have been $140.0 million and $79.2 million, respectively, an increase of $60.8 million or 77%; and gross margin would have been 77% and 72%.

Gross margin increased due to high growth rates in our merchant business which yields a higher gross profit per transaction compared with our agency business. In addition, efficiencies were achieved through website improvements which enabled our customers to make changes to their itinerary online and navigate through our websites more efficiently, reduced the number of calls and e-mails to our call centers, which enabled us to manage our call center costs more effectively, and achieve greater economies of scale and reduced costs per transaction at our call centers. The increase in gross margin was partially offset as March 2002 results included only a partial quarter for CCV and CCV s commissions paid to travel agents which is included in cost of revenues.

Product Development

	Three Months Ended March 31,		
	2003	**2002**	**% Change**
	($ in thousands)		
Product development	$ 10,964	$ 8,727	26%
% of revenues	6%	8%	

Product development expenses consist primarily of payroll and related expenses for website development, maintenance, localization and acquired content. Product development expenses for the three months ended March 31, 2003 and 2002 were $11.0 million and $8.7 million, representing 6% and 8% of revenues, respectively. The increase in absolute dollars is primarily due to additional personnel involved in the development, enhancements, and localization of our websites. Also, we have provided greater and richer content to travelers to enhance the customers buying experience. In October 2002, we acquired Newtrade Technologies, Inc. (Newtrade) for which a substantial number of Newtrade s employees are classified as product development.

We expect to continue to invest in technology and improvements to our websites, which may include, but are not limited to, hiring additional employees, offering additional website features as well as continuing our international expansion and investment in corporate travel.

Sales and Marketing

	Three Months Ended March 31, 2003	2002	% Change
	($ in thousands)		
Sales and marketing	$ 62,465	$ 34,836	79%
% of revenues	31%	30%	

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Sales and marketing expenses consist of advertising, distribution and public relations expenses as well as personnel-related costs. Our distribution activities relate to associate marketing agreements with various websites such as MSN.com and our WWTE partners. Sales and marketing expenses for the three months ended March 31, 2003 and 2002 were $62.5 million and $34.8 million representing 31% and 30% of revenues, respectively. The increase in absolute dollars is primarily due to increased domestic and international promotional and distribution activities intended to being additional customers to our websites. Our promotional activities range from radio to magazine and other paper media advertising which create general brand awareness. We also expanded our distribution channels by increasing our presence at search engine portals as well as the number of WWTE partners.

General and Administrative

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
General and administrative	$ 15,499	$ 8,241	88%
% of revenues	8%	7%	

General and administrative expenses consist primarily of compensation for personnel to support functions such as our executive leadership, finance, legal and human resources. In addition to people-related costs, other significant expenses include professional fees and depreciation of certain internally-developed systems. General and administrative expenses for the three months ended March 31, 2003 and 2002 were $15.5 million and $8.2 million, representing 8% and 7% of revenues, respectively. The increase in absolute dollars is due to additional personnel required to support our business growth and additional personnel from the acquisitions of CCV, Metropolitan and Newtrade. In addition, during the quarter ended March 31, 2002, we incurred significant costs related to acquiring and developing systems as we migrated from Microsoft s systems onto our own. These costs were capitalized and our expenses in the quarter ended March 31, 2003 now reflect the depreciation of those assets.

Amortization of Intangible Assets

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
Amortization of intangible assets	$ 4,552	$ 8,768	-48%
% of revenues	2%	8%	

Amortization of intangible assets relate to our acquisitions of Travelscape and VacationSpot in March 2000, CCV in March 2002, Metropolitan in July 2002 and Newtrade in October 2002. Amortization of intangibles for the three months ended March 31, 2003 and 2002 were $4.6 million and $8.8 million, representing 2% and 8% of revenues, respectively. The decrease is due to the portion of Travelscape and VacationSpot intangible assets with estimated useful lives of two years were fully amortized as of March 17, 2002, resulting in a decrease of amortization of intangible assets in 2003. However, the decrease was partially offset by the amortization of CCV s, Metropolitan s and Newtrade s intangible assets.

Recognition of Stock-Based Compensation

	Three Months Ended March 31,		
	2003	2002	% Change
		(restated)	
	($ in thousands)		
Recognition of stock-based compensation	$ 7,681	$ 1,606	378%
% of revenues	4%	1%	

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On January 1, 2003, we adopted SFAS No. 123, the fair value based method of accounting for stock-based employee compensation. Prior to January 1, 2003, our accounting was in accordance with APB No. 25, the intrinsic value based method and our expense for the three months ended March 31, 2002 was related to the unvested options to purchase Expedia common stock, (Expedia Options) that resulted from conversion of Microsoft common stock held by employees at our initial public offering in 1999. These stock option issuances were deemed to be new grants and created non-cash compensation expense equal to the difference between the option exercise price and the fair market value of the common stock at the date of grant.

Stock-based compensation for the three months ended March 31, 2003 and 2002 was $7.7 million and $1.6 million, representing 4% and 1% of revenues, respectively. The increase is primarily due to compensation expense related to severance obligations associated with our former Chief Executive Officer s resignation agreement and equity compensation awards granted during the quarter ended March 31, 2003 and accounted for in accordance with SFAS No. 123. This was partially offset by the decrease in the stock compensation expense related to Expedia Options which were amortized utilizing the accelerated method over the vesting period of each individual grant. The accelerated method results in higher amortization amounts during the beginning of the amortization period. As of March 31, 2003, the Expedia Options were fully amortized.

Net Interest Income and Other

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
Net interest income and other	$ 2,562	$ 2,683	-5%
% of revenues	1%	2%	

Net interest income and other for the three months ended March 31, 2003 and 2002 was $2.6 million and $2.7 million, representing 1% and 2% of revenues, respectively. Even though our cash and investments in marketable securities have increased significantly, a decline in interest rates has caused interest income to decrease. Average interest rate yields for treasury securities with a 3 year maturity for the three months ended March 31, 2003 and 2002 were approximately 2.1% and 3.8%, respectively.

USA Merger-Related Expense

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
USA merger related expense	$ 2,002	$ 9,860	-80%

% of revenues	1%	8%

USA merger-related expense for the three months ended March 31, 2003 and 2002 were $2.0 million and $9.9 million, representing 1% and 8% of revenues, respectively. During the three months ended March 31, 2003, we incurred financial advisory fees related to our merger agreement with USA, announced on March 19, 2003. During the three months ended March 31, 2002, we incurred various financial advisory, legal, tax and accounting fees in connection with USA acquiring a controlling interest in Expedia in February 2002.

Provision for Income Taxes

	Three Months Ended March 31,		
	2003	2002	% Change
	($ in thousands)		
Provision for income taxes	$ 15,337	$ 4,614	232%
% of revenues	8%	4%	

Provision for income taxes for the three-months ended March 31, 2003 and 2002 was $15.3 million and $4.6 million, representing 8% and 4% of revenues, respectively. The increase is due to additional pretax income which was partially offset by a decrease in the effective tax rate due to the complete utilization of non-deductible permanent items during 2002 related to the amortization of intangibles from the Travelscape and VacationSpot acquisitions.

Liquidity and Capital Resources

Our principal sources of liquidity are our cash, cash equivalents and marketable securities. The balances of these items totalled $771.4 million and $365.4 million at March 31, 2003 and 2002, respectively. This increase of more than $400 million is driven by two primary factors: our growing profitability coupled with the fact that certain of our expenses are non-cash transactions; and the increase in working capital cash flows from our fast-growing merchant business.

Net cash provided by operating activities was $209.4 million and $119.8 million during the three-months ended March 31, 2003 and 2002. The changes in working capital from our merchant business have been a significant source of cash. In our merchant business, we receive cash from customers on hotel and air bookings before the stay or flight has occurred. These amounts are classified on our balance sheet as deferred merchant bookings. The payment to the suppliers related to these bookings is not made until approximately one week after booking for air travel and, for all other merchant bookings, after the customer s use and subsequent billing from the supplier. Therefore, especially for the hotel business, which is the majority of our merchant bookings, there may be a significant period of time from the receipt of the cash from the customers to the payment to the suppliers. For the three-months ended March 31, 2003 and 2002 contributions to our positive cash flows included: net merchant bookings of $102.8 million and $49.0 million, respectively, an increase of $53.8 million; and accounts payable and accrued expenses of $54.4 million and $41.6 million, respectively, an increase of $12.8 million. The increases resulted from the growth in our worldwide merchant hotel business. There is a seasonal element to cash flow related to merchant bookings, as the first quarter has traditionally been a quarter where hotel bookings significantly exceed stays, resulting in much higher cash flow related to working capital. In the other quarters, the difference between bookings and stays tends to be more even. In addition to the working capital impact, certain of our expenses are non-cash transactions, such as the provision for income taxes and depreciation and amortization which also contributed to the increase in cash flows from operations.

Net cash used in investing activities was $143.2 million and $42.6 million during the three-months ended March 31, 2003 and 2002. In June 2002, we began investing in certain marketable securities, which consist of high-quality short to intermediate term agency securities. These investments are intended to provide additional interest income while at the same time ensuring liquidity and safety of the principal. During the three-months ended March 31, 2003, we purchased $214.7 million and sold $78.5 million of such investments. During the three-months ended March 31, 2002, we paid total net cash of $35.3 million to acquire CCV.

Net cash used in financing activities was $14.8 million during the three-months ended March 31, 2003 and net cash provided by financing activities was $49.8 million during the three-months ended March 31, 2002. During the three-months ended 2003, we repurchased 816,000 shares of our common stock for $25.0 million. As part of the CCV acquisition in March 2002, we issued 1,873,630 shares of common stock to USA at a price of $25.08 in a private placement, raising approximately $48.1 million. Stock option and warrant exercises by employees and directors were a source of cash totaling $12.2 million and $11.6 million for the three months ended March 31, 2003 and 2002, respectively. A substantial number of stock options are currently vested and additional substantial amounts will become vested during the rest of this year. As options are exercised, they will also affect operating results, as we incur payroll tax expenses on the taxable portion of employees gains upon exercise. These expenses are recognized in the cost of revenues, product development, sales and marketing, and general and administrative line items of our consolidated financial statements.

As of March 31, 2003 and 2002, we had two bank letter of credit facilities in the combined amounts of $35 million and $17 million, respectively. A substantial amount of the letters of credit are issued to hotel properties to guarantee payment for the potential purchase of hotel rooms. Both letters of credit facilities previously required full collateralization for issued letters of credit with restricted deposits. However, as of December 31, 2002, one credit facility for $20.0 million was amended to release the pledge of restricted deposits in exchange for standard liquidity, capital and financial covenants. As of March 31, 2003 and 2002, we had $17.6 million and $14.9 million, respectively, of outstanding letters of credit drawn against these facilities. No claims have been made against any letters of credit. As of March 31, 2003, we were in compliance with these financial covenants.

During 2002, we provided bank guarantees to government regulatory authorities in the U.K. and Germany in order to operate our vacation packages business in those respective countries. As of March 31, 2003, we had bank guarantees in the amount of $9.7 million.

The terrorist activities of September 11, 2001, and the uncertainty caused by the current economic, political and transportation climates may affect future demand for our products and services. As previously discussed, a significant amount of operating cash flow is from increased deferred merchant bookings and the period between receipt of cash from the customer and payment to non-air merchant suppliers. In a time of flat or declining merchant bookings, we would expect to experience a related decrease in operating cash flow, or negative operating cash flows. We believe that our financial situation would enable us to absorb a significant potential downturn in business. As a result, we anticipate being able to meet our operating and capital cash needs without any need for additional funding. We intend to continue to invest in marketable securities with maturities of three years or less in order to ensure liquidity and safety of principal.

Factors That May Impact Future Results Of Operations

While management is optimistic about our long-term prospects, an investment in our securities involves a high degree of risk. Investors evaluating Expedia and our business should carefully consider the factors described below and all other information contained in our quarterly report on Form 10-Q before making an investment decision with respect to our securities. Any of the following factors could materially impact our business, operating results and financial condition. Additional factors and uncertainties not currently known to us or that we currently consider immaterial could also harm our business, operating results and financial condition. Investors could lose all or part of their investment as a result of these factors.

Failure to complete the merger with USA could negatively impact the price of our common stock

On March 19, 2003, Expedia and USA announced that they entered into a merger agreement by which USA would acquire the outstanding Expedia shares it does not already own. If our proposed merger with USA is not completed for any reason, the price of our common stock may decline to the extent that the current market price of our common stock reflects a market assumption that the merger will be completed. We will also be required to pay costs incurred in connection with the merger, such as our legal, accounting and financial advisory fees, even if the merger is not completed.

We believe that as a result of the announcement of the merger with USA, the price of our common stock will be based in large part on the price of USA common stock; the price of USA s common stock may be affected by factors different from those affecting the price of our common stock

Prior to the completion of the merger, we expect that our common stock will trade in tandem with USA common stock given the fixed exchange ratio for the merger. USA s business differs somewhat from our business, and USA s results of operations and the price of USA s common stock may be affected by factors different from those that affect our results of operations and the price of our common stock before the announcement of the merger. Please see USA s public filings with the Securities and Exchange Commission, including the risk factors contained in USA s most recent Annual Report on Form 10-K and Form 10-Q.

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USA exercises significant control over Expedia

At April 11, 2003, USA owned approximately 59% of our outstanding common equity and 94.9% of our total voting power. As a result, USA generally has the ability to control the outcome of any matter submitted for the vote or consent of our shareholders, except where a separate vote of the holders of our common shares is required by Washington law. In addition, USA controls our board of directors. USA generally will not be restricted with regard to its ability to control the election of our directors, to cause the amendment of our articles of incorporation or bylaws, or generally to exercise a controlling influence over our business and affairs.

Conflicts of interest may arise between USA and Expedia, which may be resolved in a manner that adversely affects our business, financial condition or results of operations

Conflicts of interest may arise between us, on the one hand, and USA and its other affiliates, on the other hand, in areas relating to past, ongoing and future relationships, including corporate opportunities, potential acquisitions or financing transactions, sales or other dispositions by USA of its interest in Expedia and the exercise by USA of its ability to control our management and affairs. Conflicts, disagreements or other disputes between Expedia and USA may arise and may be resolved in a manner that adversely affects our business, financial condition or results of operations.

For instance, USA is engaged in a diverse range of media, electronic and online commerce businesses, including businesses that offer services that overlap with ours, such as Hotels.com. While USA encourages its operating units to cooperate with each other and Expedia may benefit from being able to better serve its customers through such cooperation, Expedia also could lose business to such other USA operating units. In addition, USA or its affiliates may acquire additional businesses that may conflict or overlap with our business interests. Our amended and restated articles of incorporation include provisions which provide that (1) neither USA nor any of its affiliates will have any duty to refrain from engaging in the same or similar activities or lines of business of Expedia, thereby potentially diverting business from us, and (2) neither USA nor any of its affiliates will have any duty to communicate or offer corporate opportunities to us and none of them will be liable for breach of any fiduciary duty to us, as a shareholder of Expedia or otherwise, in connection with such opportunities, provided that the procedures provided for in our articles of incorporation are followed.

Our directors, officers and former officers may have interests in USA and its subsidiaries that could create potential conflicts of interest

Ownership interests of directors or officers of Expedia in USA common stock, or ownership of directors or officers of USA in Expedia common shares or service as both a director or officer of Expedia and a director, officer or employee of USA, could create or appear to create potential conflicts of interest when directors and officers are faced with decisions that could have different implications for Expedia and USA. Barry Diller, chairman of the board of directors of USA, is also chairman of the board of directors of Expedia. A majority of our board of directors are also directors, officers or employees of USA. In addition, interlocking relationships may exist between certain members of our board of directors and members of the boards of directors of other USA subsidiaries that provide services that overlap ours, including Hotels.com, and important suppliers of ours that also have strong business relationships with our direct competitors. Our executive officers also hold options to purchase shares of USA common stock. As of April 11, 2003, seven of our executive officers have vested options to purchase an aggregate of 112,500 shares of USA common stock. On February 5, 2003, we announced that Richard Barton would resign as our President and Chief Executive Officer effective March 31, 2003 and join the board of directors of USA.

Declines or disruptions in the travel industry, such as those caused by terrorism, war, severe acute respiratory syndrome (SARS), bankruptcies or general economic downturns, could reduce our revenues

We depend on the stability of the travel industry and the viability of travel suppliers. Our business is highly sensitive to economic conditions as well as issues that impact travel safety. We could experience a protracted

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decrease in demand for our travel services due to fears regarding acts of terrorism, breakouts of war, military responses to acts of terrorism, SARS and increased costs and reduced operations by airlines due, in part, to new security directives adopted by the Federal Aviation Administration. The SARS virus, which has spread to persons in various parts of Asia, including China, Hong Kong and Singapore, may cause travelers to become more reluctant to travel by air. Since the outbreak of the virus, travel to Asia and its neighboring regions has declined, which may reduce the demand for our travel services. The risk of the continued spread of SARS or the perception that SARS is spreading could have a negative impact on the travel industry and adversely effect our results of operations. This potential decrease in demand for our travel services, depending on its scope and duration which we cannot predict at this time together with any future issues impacting travel safety, could significantly impact our long-term results of operations or financial condition. In addition, in connection with certain events, such as terrorist activity, war or SARS outbreaks, that have the effect of disrupting the existing travel plans of a significant number of our customers, we may incur additional costs if we decide to provide economic relief to customers by not charging cancellation fees or by refunding the price of tickets that are not used.

Some major airlines, most notably US Airways and the parent company of United Airlines, have sought bankruptcy protection and others may consider bankruptcy relief. As a result of bankruptcy or other financial difficulties, these airlines may reduce their fleets and the number of available flights, which could result in lower travel bookings volumes for us. The financial difficulties facing the airlines increase the risk that airlines may not perform on our contracts with them, including the risk we may not be paid for services provided to them. We have also paid merchant air suppliers for tickets in advance of travel. These amounts are classified as prepaid merchant bookings on our balance sheet. Should a supplier go out of business, we may be responsible for fulfilling the travel plans of our customers by purchasing tickets on another carrier, which could involve a substantial cost. As a result of airline bankruptcies we may incur additional customer service costs, face potential liability to customers for tickets that are not honored by the bankrupt airline, and we may lose revenue from hotel bookings that are associated with the purchase of tickets from the bankrupt airline.

Other adverse trends or events that tend to reduce travel and may reduce our revenues include:

- political instability;
- regional hostilities;
- price escalation in the airline industry or other travel-related industries;
- increased occurrence of travel-related accidents;
- airline or other travel-related strikes;
- increased airport security that could reduce the convenience of air travel;
- escalation of fuel prices might make travel more expensive and less desirable to consumers;
- strikes within the travel industry could reduce availability of inventory and increase costs to consumers; and
- bad weather

The seasonality of our business may make quarter-to-quarter comparisons of our financial results a poor indication of our performance; the seasonality of our business may place increased strain on our operations

Our business experiences seasonal fluctuations, reflecting seasonal trends for the products and services offered by our websites. For example, traditional leisure travel supplier and agency bookings typically are highest in the first two calendar quarters of the year as consumers plan and purchase their spring and summer travel and then the number of bookings flattens in the last two calendar quarters of the year. These factors could cause our revenues to fluctuate from quarter to quarter. Our results may also be affected by seasonal fluctuations in the inventory made available to us by our travel suppliers. For instance, during seasonal periods when demand is high, suppliers may impose blackouts for their inventory that prohibit us from selling their inventory during such periods.

We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance as a result of this seasonality. Our historical growth has tended to mask the effects of seasonality on our operating results, and to the extent our rate of growth slows in the future these effects may become more pronounced.

If too many customers access our Web sites within a short period of time during our peak seasons, we may experience system interruptions that make our web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce the attractiveness of our products and services. In addition, we may be unable to hire adequate staff to operate our business during these peak periods.

Because our results of operations are difficult to predict, they may fluctuate substantially from the estimates of securities analysts or from our published budgets

In the event that our operating results fall below the expectations of securities analysts or investors, the trading price of our common shares may decline significantly. Factors that may cause us to fail to meet the expectations of securities analysts or investors include the following:

- our inability to obtain travel inventory on satisfactory terms from our travel suppliers;
- decreases in commission rates from airlines or increases in the costs of acquiring merchant travel inventory;
- the ability of our competitors to offer new or enhanced websites, services or products or similar services or products with lower prices;
- our inability to obtain new customers at reasonable cost, retain existing customers or encourage repeat purchases;
- decreases in the number of visitors to our websites or our inability to convert visitors to our websites into customers;
- our inability to adequately maintain, upgrade and develop our websites, the systems that we use to process customers orders and payments or our computer network;
- our inability to retain existing airlines, hotels, rental car companies and other suppliers of travel services or to obtain new travel suppliers;
- fluctuating gross margins due to a changing mix of revenues;
- the termination of existing relationships with key service providers or our failure to develop new ones;
- the amount and timing of operating costs relating to expansion of our operations;

- economic conditions specific to the Internet, online commerce and the travel industry; and

- a decrease in overall travel spending due to terrorism, war, economic recession, bad weather or other external factors.

We depend on our relationships with travel suppliers and distribution partners and adverse changes in these relationships could affect our inventory of travel offering and our transaction revenue

Our business relies on our relationships with our travel suppliers and distribution partners. Adverse changes in any of these relationships could reduce the amount of inventory that we are able to offer through our websites. We depend on travel suppliers to enable us to offer our customers comprehensive access to travel services and products. Consistent with industry practices, we currently have few agreements with our travel suppliers obligating them to provide inventory for us to sell through our websites. It is possible that travel suppliers may choose not to make their inventory of services and products available through our distribution channels. Travel suppliers could elect to sell exclusively through other sales and distribution channels or to restrict our access to their inventory. We also depend on travel suppliers for advertising revenues. If our travel suppliers chose not to make their services and products available to us, or not to advertise with us or if we are unable to negotiate acceptable terms with our suppliers, it could significantly decrease the amount or breadth or depth of our inventory of available travel offerings. Of particular note is Orbitz, the airline direct-distribution website owned by American Airlines, Continental Airlines, Delta Air Lines, Northwest Airlines and United Air Lines, and Travelweb, an online distributor of hotel rooms owned by Hilton, Hyatt, Mariott, Six Continents and Starwood. Additionally, American Airlines, United Airlines, Northwest Airlines, Continental Airlines, US Airways Group and America West Airlines own a website known as Hotwire, which offers unpublished special fares on certain carriers. If a substantial number of our suppliers choose to restrict their special inventory solely to the distribution channels that they own, such action may have a material adverse affect on our business.

In addition to the impact on our supply, we may experience an adverse impact on our business due to the declining financial health of many of our travel suppliers. We may experience accounts receivable collections issues and this may result in the recording of bad debts expense or in some cases, a reduction in revenues.

Efforts by our suppliers to reduce distribution costs, such as a decline in commission rates and fees or the elimination of commissions, could reduce our revenues and margins

A portion of our revenues depends on the commissions and fees paid by travel suppliers for bookings made through our travel service. Generally, we do not have written commission agreements with our hotel suppliers. We generally negotiate commissions and fees with our other travel suppliers. Recently, airlines have cut or eliminated commission levels to travel agents. We cannot assure you that airlines, hotel chains or other travel suppliers will not reduce current industry commission rates further or eliminate commissions entirely, either of which could reduce our revenues and margins.

A portion of our revenues depends on payments from our Global Distribution System (GDS) partners as consideration for fees received by them from suppliers for transactions generated through one of our five distribution channels. Generally, we have written agreements with respect to these payments from our GDS partners. Nevertheless, there can be no assurance that our GDS partners will not reduce these payments or will not eliminate them entirely over time, either of which could reduce our revenues and margins. In this regard, on November 12, 2002, the Department of Transportation issued a Notice of Proposed Rulemaking regarding its existing rules governing certain GDS s known as airline computer reservation systems. These proposed rules expressly seek to give airlines more flexibility in bargaining with the companies that run these computer reservation systems. To the extent that these proposed rules become final, any of our GDS partners could negotiate to receive less compensation from an airline, which in turn could cause that GDS partner to reduce the segment fee payments that it will pay Expedia for sales of the relevant airline s tickets.

The current downturn in the airline industry has also caused our airline travel suppliers and our GDS partners to focus on reducing all costs. Airlines have reduced or eliminated commission payments to certain travel agents, airlines and GDS in an effort to reduce distribution costs. Future efforts to further reduce such payments could adversely impact our revenues. It is possible that we may be unable to reach distribution agreements with one or more major airlines in the future, which could result in flights on such airlines not being available on our websites. It is also possible that we may be subject to terms that adversely impact our margins on air travel revenue.

Similarly, many of our hotel partners face challenging market conditions brought on by reduced demand, pricing softness and lower occupancy levels. In response to these challenges, our hotel partners are increasingly focused on maintaining profitability by controlling expenses, including distribution costs. As a result, we may from time to time be asked by a certain hotel partner to renegotiate commercial terms of our agreement with them. We treat each of these conversations on a case by case basis in consideration of a variety of economic factors and with equal emphasis on maintaining healthy long-term relationship with our hotel partners going forward.

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We compete with a variety of companies with respect to each product or service we offer

These competitors include:

- Internet travel agents such as Travelocity.com, Orbitz.com and American Express Interactive, Inc.;
- local, regional, national and international traditional travel agencies;
- consolidators and wholesalers of airline tickets, hotels and other travel products, including Hotwire.com, Cheaptickets.com and Priceline.com;
- airlines, hotels, rental car companies, cruise operators and other travel service providers, whether working individually or collectively, some of which are suppliers to our websites; and
- operators of travel industry reservation databases, such as Sabre and Pegasus.

In addition, some of the services provided by other USA companies such as Hotels.com are similar to ours and to that extent, business could be diverted away from Expedia.

In addition to the traditional travel agency channel, many travel suppliers also offer their travel services as well as third-party travel services directly to consumers through their own websites or by telephone. These travel suppliers include many suppliers with which we do business. As the demand for online travel services grows, we believe that travel suppliers, traditional travel agencies, travel industry information providers and other companies will increase their efforts to develop services that compete with our services by selling inventory from a wide variety of suppliers. We cannot assure you that our online operations will compete successfully with any current or future competitors online or offline.

Because we participate in an intensely competitive market place against a variety of well-capitalized, scaled offline and online travel distributors, we believe that maintaining and enhancing the Expedia brand is a critical. Our brand is a central piece of our efforts to attract and expand our online traffic as well as compete with traditional travel agencies and other travel service providers. The vast number of travel service providers that offer competing services increases the importance of maintaining and enhancing our brand recognition. Promotion of the Expedia brand will depend largely on our success in providing a high-quality experience supported by a high level of customer service. Some of our competitors may be able to secure services and products from travel suppliers on more favorable terms. In addition, the introduction of new technologies and the expansion of existing technologies may increase competitive pressures. Increased competition may result in reduced operating margins, as well as loss of market share and brand recognition. We cannot assure you that we will be able to compete successfully against current and future competitors. Competitive pressures faced by us could have a material adverse effect on our business, operating results and financial condition.

Interruptions in service from third parties could impair the quality of our service

We rely on third-party computer systems and third-party service providers, including the computerized global distribution systems of the airline, hotel and car rental industries to make airline ticket, hotel room and car rental reservations and credit card verifications and confirmations.

Currently, a majority of our transactions are processed through two GDS partners: Worldspan, L.P. and Pegasus Solutions, Inc. We rely on TRX, Inc. and PeopleSupport, Inc. to provide a significant portion of our telephone and e-mail customer support, as well as to print and deliver airline tickets as necessary. Any interruption in these third-party services or deterioration in their performance could impair the quality of our service. If our arrangement with any of these third parties is terminated, we may not find an alternate source of systems support on a timely basis or on commercially reasonable terms. In particular, any migration from the Worldspan system could require a substantial commitment of time and resources and harm our business.

We rely on a third party to provide our hosting services. We do not maintain fully redundant systems or alternative providers of hosting services. As a result, a system interruption or shutdown at the hosting facility that we use could result in lengthy interruptions in our services. Our business interruption insurance may not be sufficient to compensate us for losses that may occur.

Our success depends on maintaining the integrity of our systems and infrastructure

In order to be successful, we must continue to provide reliable, real-time access to our systems for our customers and suppliers. As our operations continue to grow in both size and scope, domestically and internationally, we will need to improve and upgrade our systems and infrastructure to offer an increasing number of customers and travel suppliers enhanced products, services, features and functionality. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources before the volume of business increases, with no assurance that the volume of business will increase. Consumers and suppliers will not tolerate a service hampered by slow delivery times, unreliable service levels or insufficient capacity, any of which could have a material adverse effect on our business, operating results and financial condition.

In this regard, our operations face the risk of systems failures. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, break-ins, earthquake and similar events. We do not currently have a back-up data center. Our business interruption insurance may not adequately compensate us for losses that may occur. The occurrence of a natural disaster or unanticipated problems at our facilities in Washington or Travelscape s facilities in Nevada could cause interruptions or delays in our business, loss of data or render us unable to process reservations. In addition, the failure of our computer and communications systems to provide the data communications capacity required by us, as a result of human error, natural disaster or other operational disruptions could result in interruptions in our service. The occurrence of any or all of these events could adversely affect our reputation, brand and business.

Our business is exposed to risks associated with online commerce security and credit card fraud

Consumer concerns over the security of transactions conducted on the Internet or the privacy of users may inhibit the growth of the Internet and online commerce. To transmit confidential information such as customer credit card numbers securely, we rely on encryption and authentication technology. Unanticipated events or developments could result in a compromise or breach of the systems we use to protect customer transaction data. Furthermore, our servers may also be vulnerable to viruses transmitted via the Internet. While we proactively check for intrusions into our infrastructure, a new and undetected virus could cause a service disruption.

To date, our results have been impacted due to accounting reserves we record for reservations placed on our website with fraudulent credit card data. We record these reserves because, under current credit card practices and the rules of the Airline Reporting Corporation, we may be held liable for fraudulent credit card transactions on our websites and other payment disputes with customers. We have put additional anti-fraud measures in place above and beyond our existing credit card verification procedures; however, a failure to control fraudulent credit card transactions adequately could further adversely affect our business.

Rapid technological changes may render our technology obsolete or decrease the competitiveness of our services

To remain competitive, we must continue to enhance and improve the functionality and features of our websites. The Internet and the online commerce industry are rapidly changing. In particular, the online travel industry is characterized by increasingly complex systems and infrastructures. If competitors introduce new services embodying new technologies, or if new industry standards and practices emerge, our existing websites and proprietary technology and systems may become obsolete. Our future success will depend on our ability to do the following:

enhance our existing services;

develop and license new services and technologies that address the increasingly sophisticated and varied needs of our prospective customers and suppliers; and

respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

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Developing our websites and other proprietary technology entails significant technical and business risks. We may use new technologies ineffectively or we may fail to adapt our websites, transaction-processing systems and network infrastructure to customer requirements or emerging industry standards. If we face material delays in introducing new services, products and enhancements, our customers and suppliers may forego the use of our services and use those of our competitors.

Our international operations involve risks relating to travel patterns and practices and Internet-based commerce

We operate in the U.K., Germany, Canada, France, the Netherlands and Italy and intend to expand our operations to other countries. In order to achieve widespread acceptance in each country we enter, we believe that we must tailor our services to the unique customs and cultures of that country. Learning the customs and cultures of various countries, particularly with respect to travel patterns and practices, is a difficult task and our failure to do so could slow our growth in those countries.

In addition, we face additional risks in operating internationally, such as:

- delays in the development of the Internet as a broadcast, advertising and commerce medium in international markets;
- difficulties in managing operations due to distance, language and cultural differences, including issues associated with establishing management systems infrastructures in individual foreign markets;
- unexpected changes in regulatory requirements;
- tariffs and trade barriers and limitations on fund transfers;
- difficulties in staffing and managing foreign operations;
- potential adverse tax consequences;
- exchange rate fluctuations;
- increased risk of piracy and limits on our ability to enforce our intellectual property rights; and
- for those operations where we have physical offices, increased risk of terrorism, political instability and war.

Any of these factors could harm our business. We do not currently hedge our foreign currency exposures.

Our success depends in large part on the continuing efforts of a few individuals and our ability to continue to attract, retain and motivate highly skilled employees

We depend substantially on the continued services and performance of our senior management. These individuals may not be able to fulfill their responsibilities adequately and may not remain with us. The loss of the services of any executive officers or other key employees could hurt our business. A large number of our senior executives are significantly vested in their current stock options which vest according to time-based criteria. As a result, they will be less likely to remain with us solely to achieve vesting of the remaining unvested portion of their stock options.

As of March 31, 2003, we employed a total of 1,726 employees. In order to achieve our anticipated growth, we will need to hire additional qualified employees. If we do not succeed in attracting new employees and retaining and motivating our current personnel, our business will be adversely affected.

We may be found to have infringed on intellectual property rights of others that could expose us to substantial damages and restrict our operations

We could face claims that we have infringed the patents, copyrights or other intellectual property rights of others. In addition, we may be required to indemnify travel suppliers for claims made against them. Any claims

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against us could require us to spend significant time and money in litigation, delay the release of new products or services, pay damages, develop new intellectual property or acquire licenses to intellectual property that is the subject of the infringement claims. These licenses, if required, may not be available on acceptable terms or at all. As a result, intellectual property claims against us could have a material adverse effect on our business, operating results and financial condition.

Our websites rely on intellectual property, and we cannot be sure that this intellectual property is protected from copy or use by others, including potential competitors

We regard much of our content and technology as proprietary and try to protect our proprietary technology by relying on trademarks, copyrights, trade secret laws and confidentiality agreements with consultants. In connection with our license agreements with third parties, we seek to control access to and distribution of our technology, documentation and other proprietary information. Even with all of these precautions, it is possible for someone else to copy or otherwise obtain and use our proprietary technology without our authorization or to develop similar technology independently. Effective trademark, copyright and trade secret protection may not be available in every country in which our services are made available through the Internet, and policing unauthorized use of our proprietary information is difficult and expensive. We cannot be sure that the steps we have taken will prevent misappropriation of our proprietary information. This misappropriation could have a material adverse effect on our business. In the future, we may need to go to court to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. This litigation might result in substantial costs and diversion of resources and management attention.

We currently license from third parties, including our former parent Microsoft, some of the technologies incorporated into our websites. As we continue to introduce new services that incorporate new technologies, we may be required to license additional technology from Microsoft and others. We cannot be sure that these third-party technology licenses will continue to be available on commercially reasonable terms, if at all.

Evolving government regulation could impose taxes or other burdens on our business, which could increase our costs or decrease demand for our products

We rely upon generally available interpretations of tax laws and regulations in the countries and locales in which we operate and for which we provide travel inventory. We cannot be sure that these interpretations are accurate nor that the responsible taxing authority is in agreement with our views. The imposition of additional taxes could cause us to have to pay taxes that we currently do not collect or pay or increase the costs of our products or services or increase our costs of operations.

We are currently conducting an on-going review and interpretation of the tax laws in various states and jurisdictions relating to state and local sales and hotel occupancy taxes. We are also monitoring the effect of value added taxes in certain foreign jurisdictions in which we operate. The current business practice is that the hotels collect and remit these taxes to the various tax authorities based on the amounts collected by the hotels. Consistent with this practice, we recover the taxes from customers and remit the taxes to the hotel operators for payment to the appropriate tax authorities. Several jurisdictions have stated that they may take the position that the tax is also applicable to our gross profit on merchant hotel transactions. We have not paid nor agreed to pay such taxes but have a reserve for potential payment. We evaluate our risks on a quarterly basis and, based on our assessment, we adjust the reserve and revenue accordingly.

Federal legislation imposing limitations on the ability of states to tax Internet-based sales was enacted in 1998. The Internet Tax Freedom Act, which was extended by the Internet Non-Discrimination Act, exempts specific types of sales transactions conducted over the Internet from multiple or discriminatory state and local taxation through November 1, 2003. If this legislation is not renewed when it terminates, state and local governments could impose additional taxes on Internet-based sales and these taxes could decrease the demand for our products or increase our costs of operations.

In addition, despite the federal statute, state and local tax authorities may seek to establish that Expedia has nexus in the traditional sense or acts as a hotel operator. These jurisdictions could rule that Expedia is subject to sales and occupancy taxes and seek to collect taxes on certain forms of revenue, either retroactively or prospectively or both.

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. The Interpretation is to be adopted for financial statements for the fiscal year or interim period beginning after June 15, 2003. This Interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, and requires consolidation of the results of variable interest entities in which an entity has a majority variable interest. We do not expect the adoption of the Interpretation to have a material effect on our financial position or results of operations.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have not held derivative financial instruments at any time and currently have no debt. Near-term adverse changes in interest rates will principally affect the interest income we earn on our cash balance. If market interest rates were to decrease immediately and uniformly by 10% from levels at March 31, 2003, our net income and cash flows would decrease by an immaterial amount. We may, however, experience additional adverse changes if we incur variable-rate debt or hold derivative financial instruments in the future.

We have marketable securities that are of high-quality short to intermediate term agency securities, all of which are maintained with high credit quality financial institutions. The portfolio is reviewed on a periodic basis and adjusted in the event that the credit rating of a security held in the portfolio has deteriorated.

Our international operations expose us to some foreign currency risk; however, we do not expect fluctuations in foreign currency exchange rates to have a material effect on our financial results. We may seek to hedge this risk in the future as our foreign merchant hotel business continues to grow.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have disclosure controls and procedures designed to ensure that information required to be disclosed in our filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Within 90 days prior to the date of this report, we evaluated the effectiveness of these disclosure controls and procedures under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the date of the evaluation, our disclosure controls and procedures were effective.

Changes in Internal Controls

There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect these internal controls subsequent to the date of the evaluation.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 8 to Unaudited Condensed Consolidated Financial Statements (Commitments and Contingencies).

Between June 5 and July 26, 2001, four class action complaints, alleging violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20 of the Securities Exchange Act of 1934, were filed in the United States District Court for the Southern District of New York against Expedia, certain of its officers and directors and certain underwriters of Expedia s initial public offering (IPO). On August 9, 2001, these actions were consolidated before a single judge along with cases brought against numerous other issuers and their underwriters that make similar allegations involving the IPOs of those issuers. The consolidation was for purposes of pretrial motions and discovery only. Plaintiffs filed an amended complaint on April 20, 2002. The amended complaint alleges that Expedia s prospectus was false or misleading in that it failed to disclose (i) that the underwriters allegedly were paid excessive commissions by certain customers in return for receiving shares in the IPO and (ii) that certain of the underwriters customers allegedly agreed to purchase additional shares of Expedia in the aftermarket in return for an allocation of shares in the IPO. The complaint further alleges an agreement by the underwriters with Expedia to provide positive market analyst coverage for Expedia after the IPO that had the effect of manipulating the market for Expedia s stock. Plaintiffs contend that, as a result of the alleged omissions from the prospectus and alleged market manipulation through the use of analysts, the price of Expedia s stock was artificially inflated between November 9, 1999 and December 6, 2000, and that the defendants are liable for unspecified damages to those persons who purchased stock during that period. On July 15, 2002, Expedia and the individual defendants, along with the other issuers and their related officer and director defendants, filed a joint motion to dismiss based on common issues. Arguments for and against the motion to dismiss were presented to the court on November 1, 2002. The court denied Expedia s motion on February 19, 2003. Discovery is currently ongoing. Expedia intends to vigorously defend against this action.

On September 6, 2002, a complaint was filed with the Superior Court of the State of Washington for King County by Amazon.com Commerce Services, Inc. alleging that Expedia breached a May 25, 2001 Linking Agreement between Expedia and Amazon. Amazon alleges that Expedia breached the Linking Agreement by failing to make payments due. Amazon also alleges that Expedia refused to pay the amounts owed unless Amazon renegotiated the Linking Agreement and despite Amazon s willingness and ability to continue performing its obligations, and that as a result, Expedia is in breach of the duty of good faith and fair dealing implied in every contract. Amazon s complaint seeks a judgment of approximately $3.7 million, plus prejudgment interest, an award of attorneys fees and other unspecified damages. On March 3, 2003, Expedia answered Amazon s complaint, denied its claims and asserted affirmative defenses. Expedia also alleged that Amazon failed to perform under the Linking Agreement and we asserted counterclaims for (1) breach of contract, (2) breach of the duty of good faith and fair dealing, (3) violation of the Washington Consumer Protection Act, and (4) declaratory relief. Expedia is claiming damages in an amount to be determined at trial, and additionally we are seeking attorneys fees and costs and a declaration from the court that Amazon is in material breach of the Linking Agreement and that we have the right to terminate the term of the Linking Agreement and/or to rescind the Linking Agreement. The court s case schedule, issued upon filing of the complaint, sets a trial date of February 2, 2004. Discovery is currently ongoing. Expedia intends to vigorously defend against Amazon s claims and prosecute Expedia s counterclaims.

Following USA s announcement on June 3, 2002 that it intended to commence an exchange offer to acquire up to 100% of the outstanding shares of Expedia that it did not already own, putative class action complaints against USA, Expedia, and members of the Expedia board of directors were filed by individual shareholders of Expedia in King County Superior Court in the State of Washington. The complaints generally alleged that consummation of the exchange offer would be a breach of fiduciary duty and that the indicated exchange ratio

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was unfair to the minority shareholders of Expedia. Each of the complaints sought, among other things, injunctive relief against consummation of the exchange offer, damages in an unspecified amount and recission in the event the exchange offer occurred.

In July 2002, the actions were consolidated, and orders were entered providing that the defendants need not respond to the complaint until after the announcement of a transaction contemplating the purchase by USA of the shares of Expedia that it did not already own. The consolidated action was dismissed without prejudice on November 22, 2002.

On March 20, 2003, one day after the public announcement that USA and Expedia had entered into a definitive merger agreement, the plaintiffs in the consolidated action filed a purported notice of reinstatement of their claims. On March 20, 2003, three additional purported class actions on behalf of Expedia shareholders were filed in King County Superior Court against Expedia, USA, and members of the board of directors of Expedia. Additional purported class action complaints were filed on March 24, 2003 and April 2, 2003. These recent complaints allege, in essence, that the defendants breached their fiduciary duties to Expedia s public shareholders by entering into and/or approving the merger agreement, which allegedly does not reflect the true value of Expedia. The complaints seek to enjoin consummation of the transaction or, in the alternative, to rescind the transaction, as well as damages in an unspecified amount. On April 22, 2003, the Washington court entered an Order formally reinstating the consolidated action. On May 5, 2003, upon the stipulation of all parties, the court consolidated the five recently filed class actions into the consolidated action.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

none.

ITEM 4. SUBMISSION OF MATTER TO A VOTE OF SECURITY HOLDERS

none.

ITEM 5. OTHER INFORMATION

Rule 10b5-1 Trading Plans

One of our executive officers currently has in effect a Rule 10b5-1 sales plan for shares of our common stock. Rule 10b5-1 requires, among other things, that the trading plans be established only at a time when the officer is not aware of material, nonpublic information. The plans specify the trading periods, which range from six months to one year, the numbers of shares to be sold, and prices at which shares may be sold. If all conditions of the plan are met, the aggregate number of shares that may be sold under the plan would be 78,000, which would equal approximately 2% of the aggregate number of shares, including restricted shares, vested and unvested warrants and vested and unvested option shares, held by the executive officers as of April 30, 2003.

Officers may amend trading plans and may sell additional shares of common stock outside of the trading plans, subject to applicable securities laws**.**

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) *Exhibits*

10.01	First Amendment to Office Lease Agreement, dated October 28, 2002, by and between EOP-Sunset North Bellevue, LLC., and Expedia, Inc.
10.02	Second Amendment to Office Lease Agreement, dated March 14, 2003, by and between WA-Sunset North Bellevue, LLC., and Expedia, Inc.
10.03	Third Amendment to Office Lease Agreement, dated March 14, 2003, by and between WA-Sunset North Bellevue, LLC., and Expedia, Inc.
10.04	Annual Incentive Plan for the calendar year ending December 31, 2003.
99.1	Certification of Erik C. Blachford Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification of Gregory S. Stanger Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) *Reports on Form 8-K*

The Company has filed the following reports on Form 8-K:

(i) On February 6, 2003 Expedia filed a Form 8-K dated February 5, 2003, pertaining to Regulation FD disclosure.

(ii) On March 7, 2003, Expedia filed a Form 8-K dated March 7, 2003, pertaining to Regulation FD disclosure.

(iii) On March 19, 2003, Expedia filed a Form 8-K dated March 18, 2003, announcing that Expedia entered into an Agreement and Plan of Merger with USA Interactive.

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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.

Date: May 15, 2003	/s/ Gregory Stanger
	Gregory S. Stanger **Sr. Vice President and** **Chief Financial Officer**

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CERTIFICATION

I, Erik C. Blachford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Expedia, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

By: /s/ ERIK C. BLACHFORD

Erik C. Blachford

President and Chief Executive Officer

(Principal Executive Officer)

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CERTIFICATION

I, Gregory S. Stanger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Expedia, Inc;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

By: /s/ GREGORY S. STANGER

Gregory S. Stanger

Chief Financial Officer

(Principal Financial and Accounting Officer)