Palo Alto Networks Inc
Form S-3ASR
June 06, 2014
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**As filed with the Securities and Exchange Commission on June 6, 2014**

**Registration No. 333-**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM S-3

**REGISTRATION STATEMENT**

***Under***

***The Securities Act of 1933***

**PALO ALTO NETWORKS, INC.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **20-2530195** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification Number)** |

**4401 Great America Parkway**

**Santa Clara, California 95054**

**(408) 753-4000**

**(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)**

**Mark D. McLaughlin**

**President and Chief Executive Officer**

**Palo Alto Networks, Inc.**

**4401 Great America Parkway**

**Santa Clara, California 95054**

**(408) 753-4000**

**(Name, address, including zip code, and telephone number, including area code, of agent for service)**

***Copies to:***

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**Jeffrey C. True**

**General Counsel**

**Palo Alto Networks, Inc.**

**4401 Great America Parkway**

**Santa Clara, California 95054**

**(408) 753-4000**

**Approximate date of commencement of proposed sale to the public**: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. x

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |

**CALCULATION OF REGISTRATION FEE**

| Title of Each Class of Securities to be Registered | Amount to be Registered (1) | Proposed Maximum | Proposed Maximum Aggregate Offering Price (2) | Amount of Registration Fee |
|---|---|---|---|---|

| | | Offering Price Per Share (2) | | |
|---|---|---|---|---|
| Common stock, par value $0.0001 per share | 1,543,924 | $73.60 | $113,632,807 | $14,636 |

(1) Includes 1,080,747 shares of the Registrant s common stock outstanding and 463,177 shares of the Registrant s common stock that may be issued upon the exercise of a warrant held by the selling stockholder. Pursuant to Rule 416(a) of the Securities Act of 1933, as amended, this Registration Statement shall also cover any additional shares of the Registrant s common stock that become issuable by reason of any stock dividend, stock split, recapitalization or other similar transaction effected without receipt of consideration that increases the number of the Registrant s outstanding shares of its common stock.

(2) Estimated in accordance with Rule 457(c) solely for purposes of calculating the registration fee on the basis of the average of the high and low prices of Registrant s common stock as reported on the New York Stock Exchange on June 2, 2014.

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**PROSPECTUS**

**1,543,924 SHARES**

**Common Stock**

The selling stockholder of Palo Alto Networks, Inc. ( Palo Alto Networks, we, us or the Company ) listed beginning page 33 may offer and resell up to 1,543,924 shares of our common stock under this prospectus. The selling stockholder acquired 1,080,747 shares of our common stock and a warrant to purchase up to 463,177 shares of our common stock pursuant to a Settlement, Release and Cross-License Agreement dated as of May 27, 2014, by and between the Company and the selling stockholder. The selling stockholder (which term as used herein includes its donees, transferees or other successors in interest) may sell these shares through public or private transactions at market prices prevailing at the time of sale or at negotiated prices. We are not selling any securities under this prospectus and will not receive any proceeds from the sale of shares of our common stock by the selling stockholder.

Our common stock is listed on the New York Stock Exchange under the symbol PANW. On June 5, 2014, the last reported sale price for our common stock on the New York Stock Exchange was $77.00 per share.

**Investing in our common stock involves risks. See Risk Factors beginning on page 3.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

**The date of this prospectus is June 6, 2014.**

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## ABOUT THIS PROSPECTUS

This prospectus is a part of a registration statement on Form S-3 that we filed with the Securities and Exchange Commission (the SEC ), utilizing a shelf registration process. Under this shelf registration process, the selling stockholder may, from time to time, offer and sell shares of our common stock, as described in this prospectus, in one or more offerings.

You should rely only on the information contained in this prospectus (as supplemented and amended). We have not authorized anyone to provide you with different information. This document may only be used where it is legal to sell these securities. You should not assume that the information contained in this prospectus is accurate as of any date other than its date regardless of the time of delivery of the prospectus or any sale of our common stock.

We urge you to read carefully this prospectus (as supplemented and amended) before deciding whether to purchase any of the shares of our common stock being offered.

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## PROSPECTUS SUMMARY

*This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all the information that you should consider before investing in our common stock. You should read the following summary together with the more detailed information regarding our company, the common stock being registered hereby, and our financial statements and notes thereto incorporated by reference in this prospectus before deciding whether to purchase shares of our common stock from the selling stockholder.*

### Overview

We have pioneered the next-generation of enterprise security with our innovative platform that allows enterprises, service providers, and government entities to simultaneously empower and secure their organizations by safely enabling the increasingly complex and rapidly growing number of applications running on their networks and by preventing breaches stemming from targeted cyber attacks. Our enterprise security platform consists of three major elements: our Next-Generation Firewall, our Next-Generation Endpoint Protection, and our Next-Generation Threat Intelligence Cloud. Our Next-Generation Firewall delivers application, user, and content visibility and control as well as protection against network-based cyber threats integrated within the firewall through our proprietary hardware and software architecture. Our Next-Generation Endpoint Protection protects against cyber attacks that aim to exploit software vulnerabilities on a broad variety of fixed and virtual endpoints. Our Next-Generation Threat Intelligence Cloud provides central intelligence capabilities as well as automation of delivery of preventative measures against cyber attacks.

Our platform offers a number of compelling benefits for our end-customers, including the ability to identify, control, and safely enable applications while offering full prevention of breaches stemming from cyber attacks in real time. We believe our platform also offers superior performance compared to legacy approaches and reduces the total cost of ownership for organizations by simplifying their enterprise security infrastructure and eliminating the need for multiple, stand-alone security appliances and software products. Our products and services can address a broad range of our end-customers enterprise security requirements, from the data center to the network perimeter, as well as the distributed enterprise, which includes branch offices and a growing number of endpoints and mobile devices.

Our platform uses an innovative traffic classification engine that identifies network traffic by application, user, and content. As a result, it provides in-depth visibility into all traffic and all applications, at the user level, at all times, and at the full speed of the network in order to control usage, content, risks, and cyber threats. This enables our end-customers to transform their organizations by safely enabling applications through a positive security model with fine-grained policy implementation capabilities and by preventing breaches stemming from cyber attacks.

The network-based element of our platform is delivered in the form of a hardware or virtual appliance and includes a suite of subscription services. The endpoint-based element of our platform is delivered in the form of software. The cloud-based element of our platform is delivered in the form of a service that can be used either in the public cloud or in a private cloud using our dedicated WF-500 appliances. Our subscription services can be easily activated on any of our appliances without requiring additional hardware or processing resources, thereby providing a seamless implementation path for our end-customers. All of our appliances incorporate our PAN-OS operating system and are based on our proprietary identification technologies, application visibility and control (App-ID), user identification (User-ID), and Content-ID, which allow security policies to be defined within the context of applications, users, and content. We deliver these capabilities through an innovative, Single Pass Parallel Processing (SP3) architecture that simultaneously performs multiple identification, security, and networking functions. As a result, our end-customers achieve safe application enablement and prevention of cyber attacks, while maintaining high network performance.

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We serve the enterprise network and endpoint security markets, which consists of Firewall, Unified Threat Management (UTM), Web Gateway, Intrusion Detection and Prevention (IDS/IPS), Virtual Private Network (VPN), and Enterprise Endpoint Security technologies.

We sell our platform through a high-touch, channel-fulfilled sales model. Our business is geographically diversified, with 66% of our total revenue from the Americas, 21% from Europe, the Middle East, and Africa (EMEA), and 13% from Asia Pacific and Japan (APAC) for the nine months ended April 30, 2014. As of April 30, 2014, we had over 17,000 end-customers in over 130 countries.

We were incorporated in 2005 as Palo Alto Networks, Inc., a Delaware corporation. Our principal executive offices are located in Santa Clara, California, and our telephone number is (408) 753-4000. Our website is www.paloaltonetworks.com. The information on or accessible through our website is not a part of, and is not incorporated or deemed to be incorporated by reference in, this prospectus. Our office address is 4401 Great America Parkway, Santa Clara, California 95054.

## The Shares Offered Under this Prospectus

| | |
|---|---|
| Common stock offered by the selling stockholder | 1,543,924 shares |
| Use of proceeds | All of the shares of our common stock being offered under this prospectus are being sold by the selling stockholder or its donees, transferees or other successors in interest. Accordingly, we will not receive any proceeds from the sale of such shares. |
| NYSE trading symbol | PANW |

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## RISK FACTORS

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in or incorporated by reference into this prospectus, before making an investment decision. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we do not currently believe are important to an investor may also harm our business operations. If any of the events, contingencies, circumstances or conditions described in the following risks actually occurs, our business, financial condition or our results of operations could be seriously harmed. If that happens, the trading price of our common stock could decline and you may lose part or all of the value of any of our shares held by you.*

### Risks Related to Our Business and Our Industry

***Our limited operating history makes it difficult to evaluate our current business and future prospects, and may increase the risk of your investment.***

We were founded in 2005 and shipped our first products in 2007. The majority of our revenue growth has occurred since 2009. Our limited operating history makes it difficult to evaluate our current business and our future prospects, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and difficulties frequently experienced by rapidly growing companies in constantly evolving industries, including the risks described in this prospectus. If we do not address these risks successfully, our business and operating results will be adversely affected, and the market price of our common stock could decline. Further, we have limited historical financial data and we operate in a rapidly evolving market. As such, any predictions about our future revenue and expenses may not be as accurate as they would be if we had a longer operating history or operated in a more predictable market.

***Our business and operations have experienced rapid growth in recent periods, and if we do not effectively manage any future growth or are unable to improve our systems and processes, our operating results will be adversely affected.***

We have experienced rapid growth and increased demand for our products over the last few years. Our employee headcount and number of end-customers have increased significantly, and we expect to continue to grow our headcount significantly over the next year. For example, from the end of the second quarter of fiscal 2014 to the end of the third quarter of fiscal 2014, our headcount increased from 1,375 to 1,556 employees, and our number of end-customers increased from more than 16,000 to over 17,000. The growth and expansion of our business and product and service offerings places a continuous significant strain on our management, operational, and financial resources. As we have grown, we have increasingly managed more complex deployments of our products and services with larger end-customers. To manage any future growth effectively, we must continue to improve and expand our information technology and financial infrastructure, our operating and administrative systems, and our ability to manage headcount, capital, and processes in an efficient manner.

We may not be able to successfully implement improvements to our systems and processes in an efficient or timely manner, and we may discover deficiencies in our existing systems and processes. We have licensed technology from third parties to help us accomplish this objective. We may experience difficulties in managing improvements to our systems and processes or in connection with third-party software, which could disrupt existing customer relationships, cause us to lose customers, limit us to smaller deployments of our products, or increase our technical support costs. Our failure to improve our systems and processes, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses, and earnings, or to prevent certain losses. In addition, our systems and processes may not prevent or detect all errors, omissions, or fraud. Our productivity and the quality of our products and services may be adversely affected if we do not integrate and train our new employees quickly and effectively, including employees we acquired in connection with our acquisition of Cyvera Ltd. ( Cyvera ). Any future

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growth would add complexity to our organization and require effective coordination throughout our organization. For example, as a result of growth in our employee headcount, we relocated our corporate headquarters to a larger office space in Santa Clara, California in November 2013. Failure to manage any future growth effectively could result in increased costs, negatively impact our end-customers satisfaction with our products and services, and harm our operating results.

***Our operating results are likely to vary significantly from period to period and be unpredictable, which could cause the market price of our common stock to decline.***

Our operating results, in particular, our revenues, gross margins, operating margins, and operating expenses, have historically varied from period to period, and we expect that this trend will continue as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- our ability to attract and retain new end-customers;
- the budgeting cycles and purchasing practices of end-customers;
- changes in end-customer, distributor or reseller requirements, or market needs;
- the cost and potential outcomes of existing and future litigation, which could have a material adverse effect on our business;
- changes in the growth rate of the enterprise security market;
- the timing and success of new product and service introductions by us or our competitors or any other change in the competitive landscape of our industry, including consolidation among our competitors or end-customers;
- changes in mix of our products and services including increases in multi-year subscriptions and support and maintenance;
- price competition;
- deferral of orders from end-customers in anticipation of new products or product enhancements announced by us or our competitors;
- our ability to successfully expand our business domestically and internationally;

the timing and costs related to the development or acquisition of technologies or businesses;

lack of synergy, or the inability to realize expected synergies, resulting from recent acquisitions;

our inability to complete or integrate efficiently any acquisitions that we may undertake;

our ability to increase the size of our distribution channel;

decisions by potential end-customers to purchase enterprise security solutions from larger, more established security vendors or from their primary network equipment vendors;

changes in end-customer attach rates and renewal rates for our services;

timing of revenue recognition and revenue deferrals;

our ability to manage production and manufacturing related costs, global customer service organization costs, inventory excess and obsolescence costs, and warranty costs;

insolvency or credit difficulties confronting our customers, which could adversely affect their ability to purchase or pay for our products and services, or confronting our key suppliers, including our sole source suppliers, which could disrupt our supply chain;

any disruption in our channel or termination of our relationship with important channel partners, including as a result of consolidation among distributors and resellers of enterprise security solutions;

- our inability to fulfill our end-customers   orders due to supply chain delays or events that impact our manufacturers or their suppliers;
- increased expenses, unforeseen liabilities, or write-downs and any impact on our results of operations from any acquisition consummated;
- seasonality or cyclical fluctuations in our markets;
- future accounting pronouncements or changes in our accounting policies;
- the impact on our overall effective tax rate caused by any reorganization in our corporate structure or any changes in our valuation allowance for domestic deferred assets;
- increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, as an increasing portion of our expenses are incurred and paid in currencies other than the U.S. dollar;
- political, economic and social instability, including the political uncertainty in Ukraine, the impact of any current and future sanctions the U.S. or other countries may impose on Russia, and any disruption this may cause to broader global industrial economy; and
- general macroeconomic conditions, both domestically and in our foreign markets.

Any one of the factors above, or the cumulative effect of some of the factors referred to above, may result in significant fluctuations in our financial and other operating results. This variability and unpredictability could result in our failure to meet our revenue, margin, or other operating result expectations or those of securities analysts or investors for a particular period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our common stock could fall substantially, and we could face costly lawsuits, including securities class action suits.

***Our revenue growth rate in recent periods may not be indicative of our future performance.***

You should not consider our revenue growth rate in recent periods as indicative of our future performance. We have recently experienced revenue growth rates of 48% and 58% in the nine months ended April 30, 2014 and nine months ended April 30, 2013, respectively. You should not rely on our revenue for any prior quarterly or annual periods as any indication of our future revenue or revenue growth. If we are unable to maintain consistent revenue or revenue growth, the market price of our common stock could be volatile, and it may be difficult to achieve and maintain profitability.

***We have a history of losses, anticipate increasing our operating expenses in the future, and may not be able to achieve or maintain profitability or maintain or increase cash flow on a consistent basis. If we cannot achieve or maintain profitability or maintain or increase our cash flow, our business, financial condition, and operating results may suffer.***

Other than fiscal 2012, we have incurred losses in all fiscal years since our inception. We incurred a net loss of $194.4 million in the first three quarters of fiscal 2014, $29.2 million in fiscal 2013, and $12.5 million in fiscal 2011. As a result, we had an accumulated deficit of $303.7 million at April 30, 2014. We anticipate that our operating expenses will increase substantially in the foreseeable future as we continue to enhance our product and service offerings, broaden our end-customer base, expand our sales channels, expand our operations, hire additional employees, and continue to develop our technology. These efforts may prove more expensive than we currently anticipate, and we may not succeed in increasing our revenues sufficiently, or at all, to offset these higher expenses. Revenue growth may slow or revenue may decline for a number of possible reasons, including slowing demand for our products or services, increasing competition, a decrease in the growth of our overall market, or a failure to capitalize on growth opportunities. Any failure to increase our revenues as we grow our business could prevent us from achieving or maintaining profitability or maintaining or increasing cash flow on a consistent basis. If we are unable to meet these risks and challenges as we encounter them, our business, financial condition, and operating results may suffer.

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***If we are unable to sell additional products and services to our end-customers or maintain or increase our installed end-customer base, our future revenue and operating results will be harmed.***

Our future success depends, in part, on our ability to expand the deployment of our platform with existing end-customers by selling additional products, to secure other areas of our end-customers network and endpoints, and by upselling additional subscription services to provide increasing levels of enterprise security. This may require increasingly sophisticated and costly sales efforts and may not result in additional sales. In addition, the rate at which our end-customers purchase additional products and services depends on a number of factors, including the perceived need for additional enterprise security products and services as well as general economic conditions. If our efforts to sell additional products and services to our end-customers are not successful, our business may suffer.

Further, existing end-customers that purchase our subscriptions have no contractual obligation to renew their contracts after the completion of their initial contract period, which is typically one year, and we cannot accurately predict renewal rates. Our end-customers renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction with our services and our end-customer support, the frequency and severity of subscription outages, our product uptime or latency, and the pricing of our, or competing, services. If our end-customers renew their subscriptions, they may renew for shorter contract lengths or on other terms that are less economically beneficial to us. We have limited historical data with respect to rates of end-customer renewals, so we may not accurately predict future renewal trends. We cannot assure you that our end-customers will renew their subscriptions, and if our end-customers do not renew their agreements or renew on less favorable terms, our revenues may grow more slowly than expected or decline.

We also depend on our installed end-customer base for future support and maintenance revenues. Our support and maintenance agreements are typically one year. If end-customers choose not to continue renewing their support and maintenance or seek to renegotiate the terms of support and maintenance agreements prior to renewing such agreements, our revenue may decline.

***We face intense competition in our market, especially from larger, well-established companies, and we may lack sufficient financial or other resources to maintain or improve our competitive position.***

The market for enterprise security products is intensely competitive, and we expect competition to increase in the future from established competitors and new market entrants. Our main competitors fall into four categories:

- large networking vendors, such as Cisco Systems, Inc. and Juniper Networks, Inc., that incorporate enterprise security features in their products;

- large companies, such as Intel Corporation, International Business Machines (IBM), and Hewlett-Packard Company (HP), that have acquired large network and endpoint security specialist vendors in recent years and have the technical and financial resources to bring competitive solutions to the market;

- independent security vendors, such as Check Point Software Technologies Ltd. and Fortinet, Inc., that offer network security products, and Symantec, Inc., that offers endpoint security products; and

- small and large companies that offer, or have announced plans that they will offer, point solutions that compete with some of the features present in our platform.

Many of our existing competitors have, and some of our potential competitors could have, substantial competitive advantages such as:

- greater name recognition and longer operating histories;
- larger sales and marketing budgets and resources;
- broader distribution and established relationships with distribution partners and end-customers;

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greater customer support resources;

greater resources to make acquisitions;

lower labor and development costs;

larger and more mature intellectual property portfolios; and

substantially greater financial, technical, and other resources.

In addition, some of our larger competitors have substantially broader and more diverse product offerings and leverage their relationships based on other products or incorporate functionality into existing products to gain business in a manner that discourages users from purchasing our products, including through selling at zero or negative margins, product bundling, or closed technology platforms. Potential end-customers may also prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features. These larger competitors often have broader product lines and market focus and may therefore not be as susceptible to downturns in a particular market. Many of our smaller competitors that specialize in providing protection from a single type of enterprise security threat are often able to deliver these specialized enterprise security products to the market more quickly than we can. Conditions in our market could change rapidly and significantly as a result of technological advancements, partnering by our competitors, or continuing market consolidation. New start-up companies that innovate and large competitors that are making significant investments in research and development may invent similar or superior products and technologies that compete with our products and technology. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources.

Some of our competitors have made acquisitions of businesses that may allow them to offer more directly competitive and comprehensive solutions than they had previously offered, such as Intel s acquisition of McAfee and Stonesoft, Check Point s acquisition of Nokia s security appliance business, and Cisco s acquisition of SourceFire. As a result of such acquisitions, our current or potential competitors might be able to adapt more quickly to new technologies and end-customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of acquisition or other opportunities more readily, or develop and expand their product and service offerings more quickly than we do. Due to various reasons, organizations may be more willing to incrementally add solutions to their existing enterprise security infrastructure from competitors than to replace it with our solutions. These competitive pressures in our market or our failure to compete effectively may result in price reductions, fewer orders, reduced revenue and gross margins, and loss of market share. Any failure to meet and address these factors could seriously harm our business and operating results.

***If functionality similar to that offered by our products is incorporated into existing network infrastructure products, organizations may decide against adding our appliances to their network, which would have an adverse effect on our business.***

Large, well-established providers of networking equipment such as Cisco and Juniper offer, and may continue to introduce, enterprise security features that compete with our products, either in stand-alone security products or as additional features in their network infrastructure products. The inclusion of, or the announcement of an intent to include, functionality perceived to be similar to that offered by our security solutions in networking products that are already generally accepted as necessary components of network architecture may have an adverse effect on our ability to market and sell our products. Furthermore, even if the functionality offered by network infrastructure providers is more limited than our products, a significant number of end-customers may elect to accept such limited functionality in lieu of adding appliances from an additional vendor such as us. Many organizations have invested substantial personnel and financial resources to design and operate their networks and have established deep relationships with other providers of networking products, which may make them reluctant to add new components to their networks, particularly from other vendors such as us. In addition, an organization s existing vendors or new vendors with a broad product offering may be able to offer concessions that we are not able to match because we currently offer only enterprise security products and have fewer resources than many of our competitors. If organizations are reluctant to add additional network infrastructure from new vendors or otherwise decide to work with their existing vendors, our ability to increase our market share and improve our financial condition and operating results will be adversely affected.

***Reliance on shipments at the end of the quarter could cause our revenue for the applicable period to fall below expected levels.***

As a result of end-customer buying patterns and the efforts of our sales force and channel partners to meet or exceed their sales objectives, we have historically received a substantial portion of sales orders and generated a substantial portion of revenue during the last few weeks of each fiscal quarter. If expected revenue at the end of any fiscal quarter is delayed for any reason, including the failure of anticipated purchase orders to materialize, our logistics partners inability to ship products prior to fiscal quarter-end to fulfill purchase orders received near the end of the fiscal quarter, our failure to manage inventory to meet demand, our inability to release new products on schedule, any failure of our systems related to order review and processing, or any delays in shipments based on trade compliance requirements, our revenue for that quarter could fall below our expectations and the estimates of analysts, which could adversely impact our business and results of operations and cause a decline in the market price of our common stock.

***If we are unable to hire, retain, train, and motivate qualified personnel and senior management, our business could suffer.***

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel, or delays in hiring required personnel, particularly in engineering and sales, may seriously harm our business, financial condition, and operating results. Although we have entered into employment offer letters with our key personnel, these agreements have no specific duration and constitute at-will employment. We are also substantially dependent on the continued service of our existing development personnel because of the complexity of our platform. Additionally, any failure to hire, train, and adequately incentivize our sales personnel could negatively impact our growth. Further, the inability of our recently hired sales personnel to effectively ramp to target productivity levels could negatively impact our operating margins. If we are not effective in managing any leadership transition in our sales organization, our business could be adversely impacted and our operating results and financial condition could be harmed.

Competition for highly skilled personnel is often intense, especially in the San Francisco Bay Area, where we have a substantial presence and need for highly skilled personnel. Additionally, the industry in which we operate generally experiences high employee attrition. We may not be successful in attracting, integrating, or retaining qualified personnel to fulfill our current or future needs. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, or that their former employers own their inventions or other work product.

Our future performance also depends on the continued services and continuing contributions of our senior management to execute on our business plan and to identify and pursue new opportunities and product innovations. The loss of services of senior management could significantly delay or prevent the achievement of our development and strategic objectives, which could adversely affect our business, financial condition, and operating results.

Our employees do not have employment arrangements that require them to continue to work for us for any specified period, and therefore, they could terminate their employment with us at any time. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees or groups could seriously harm our business.

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***We rely on third-party channel partners to sell substantially all of our products, and if our partners fail to perform, our ability to sell and distribute our products and services will be limited, and our operating results will be harmed.***

Substantially all of our revenue is generated by sales through our channel partners, including distributors and resellers. We provide our sales channel partners with specific training and programs to assist them in selling our products, but there can be no assurance that these steps will be effective. In addition, our channel partners may be unsuccessful in marketing, selling, and supporting our products and services. If we are unable to develop and maintain effective sales incentive programs for our third-party channel partners, we may not be able to incentivize these partners to sell our products to end-customers and, in particular, to large enterprises. These partners may also market, sell, and support products and services that are competitive with ours and may devote more resources to the marketing, sales, and support of such competitive products. These partners may have incentives to promote our competitors products to the detriment of our own or may cease selling our products altogether. Our agreements with our channel partners may generally be terminated for any reason by either party with advance notice prior to each annual renewal date. We cannot assure you that we will retain these channel partners or that we will be able to secure additional or replacement channel partners. The loss of one or more of our significant channel partners or a decline in the number or size of orders from them could harm our operating results. In addition, any new sales channel partner requires extensive training and may take several months or more to achieve productivity. Our channel partner sales structure could subject us to lawsuits, potential liability, and reputational harm if, for example, any of our channel partners misrepresent the functionality of our products or services to end-customers or violate laws or our corporate policies. If we fail to effectively manage our existing sales channels, if our channel partners are unsuccessful in fulfilling the orders for our products, or if we are unable to enter into arrangements with, and retain a sufficient number of, high quality channel partners in each of the regions in which we sell products and keep them motivated to sell our products, our ability to sell our products and operating results will be harmed.

***Because we depend on third-party manufacturers to build and ship our products, we are susceptible to manufacturing and logistics delays and pricing fluctuations that could prevent us from shipping customer orders on time, if at all, or on a cost-effective basis, which may result in the loss of sales and customers.***

We depend on third-party manufacturers, primarily Flextronics International Ltd., our contract manufacturer, as sole source manufacturers for our product lines. Our reliance on these third-party manufacturers reduces our control over the manufacturing process and exposes us to risks, including reduced control over quality assurance, product costs, and product supply and timing, as well as the risk that minerals which originate from the Democratic Republic of the Congo and adjoining countries, or conflict minerals, may be included in our products. Any manufacturing and logistics disruption by these third-party manufacturers could severely impair our ability to fulfill orders. In addition, we are subject to requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that require us to diligence, disclose, and report whether or not our products contain conflicts minerals. These requirements could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of semiconductor devices or other components used in our products. We may also encounter customers who require that all of the components of our products be certified as conflict free. If we are not able to meet this requirement, such customers may choose not to purchase our products, which could adversely impact sales of our products. In addition, we incur additional costs to comply with these disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products.

These manufacturers typically fulfill our supply requirements on the basis of individual orders. We do not have long term contracts with our third-party manufacturers that guarantee capacity, the continuation of particular pricing terms, or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements, which could result in supply shortages, and the prices we are charged for manufacturing services could be increased on short notice. Our contract with one of our contract manufacturers permits them to terminate the agreement for their convenience, subject to prior notice requirements. If we are required to change contract manufacturers, our ability to meet our scheduled product deliveries to our customers could be adversely affected, which could cause the loss of sales to existing or potential customers, delayed revenue or an increase in our costs which could adversely affect our gross margins. Any production interruptions for any reason, such as a natural disaster, epidemic, capacity shortages, or quality problems, at one of our manufacturing partners would negatively affect sales of our product lines manufactured by that manufacturing partner and adversely affect our business and operating results.

***Managing the supply of our products and product components is complex. Insufficient supply and inventory may result in lost sales opportunities or delayed revenue, while excess inventory may harm our gross margins.***

Our third-party manufacturers procure components and build our products based on our forecasts, and we generally do not hold inventory for a prolonged period of time. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and analyses from our sales and marketing organizations, adjusted for overall market conditions. In order to reduce manufacturing lead times and plan for adequate component supply, from time to time we may issue forecasts for components and products that are non-cancelable and non-returnable.

Our inventory management systems and related supply chain visibility tools may be inadequate to enable us to forecast accurately and effectively manage supply of our products and product components. Supply management remains an increased area of focus as we balance the need to maintain supply levels that are sufficient to ensure competitive lead times against the risk of obsolescence because of rapidly changing technology and end-customer requirements. If we ultimately determine that we have excess supply, we may have to reduce our prices and write-down inventory, which in turn could result in lower gross margins. If our actual component usage and product demand are lower than the forecast we provide to our third-party manufacturers, we accrue for losses on manufacturing commitments in excess of forecasted demand. Alternatively, insufficient supply levels may lead to shortages that result in delayed revenue or loss of sales opportunities altogether as potential end-customers turn to competitors products that are readily available. Additionally, any increases in the time required to manufacture our products or ship products could result in supply shortfalls. If we are unable to effectively manage our supply and inventory, our operating results could be adversely affected.

***Because some of the key components in our products come from limited sources of supply, we are susceptible to supply shortages or supply changes, which could disrupt or delay our scheduled product deliveries to our customers and may result in the loss of sales and customers.***

Our products rely on key components, including integrated circuit components, which our contract manufacturers purchase on our behalf from a limited number of suppliers, including sole source providers. The manufacturing operations of some of our component suppliers are geographically concentrated in Asia and elsewhere, which makes our supply chain vulnerable to regional disruptions. A fire, flood, earthquake, tsunami or other disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these component suppliers facilities could significantly affect our ability to obtain the necessary components for our products, which could result in a substantial loss of sales and revenue and a substantial harm to our operating results. Similarly, a localized health risk affecting employees at these facilities, such as the spread of a pandemic influenza, could impair the volume of components that we are able to obtain, which could result in substantial harm to our operating results.

We do not have volume purchase contracts with any of our component suppliers, and they could cease selling to us at any time. In addition, our component suppliers change their selling prices frequently in response to market trends, including industry-wide increases in demand, and because we do not have volume purchase contracts with these suppliers, we are susceptible to price fluctuations related to raw materials and components. If we are unable to pass component price increases along to our customers or maintain stable pricing, our gross margins and operating results could be negatively impacted. If we are unable to obtain a sufficient quantity of these components in a timely manner for any reason, sales of our products could be delayed or halted or we could be forced to expedite shipment of such components or our products at dramatically increased costs, which would negatively impact our revenue and gross margins. Additionally, poor quality in any of the sole-sourced components in our products could result in lost sales or lost sales opportunities. If the quality of the components does not meet our or our end-customers requirements, if we are unable to obtain components from our existing suppliers on commercially reasonable terms, or if any of our sole source providers cease to remain in business or continue to manufacture such components, we could be forced to redesign our products and qualify new components from alternate suppliers. The resulting stoppage or delay in selling our products and the expense of redesigning our products could result in lost sales opportunities and damage to customer relationships, which would adversely affect our business and operating results.

***If we are not successful in executing our strategy to increase sales of our products to new and existing medium and large enterprise end-customers, our operating results may suffer.***

Our growth strategy is dependent, in part, upon increasing sales of our products to medium and large enterprises. Sales to these types of end-customers involve risks that may not be present (or that are present to a lesser extent) with sales to smaller entities. These risks include:

- competition from larger competitors, such as Cisco, Check Point, and Juniper, that traditionally target larger enterprises, service providers, and government entities and that may have pre-existing relationships or purchase commitments from those end-customers;

- increased purchasing power and leverage held by large end-customers in negotiating contractual arrangements with us;

- more stringent requirements in our worldwide support service contracts, including stricter support response times and penalties for any failure to meet support requirements; and

- longer sales cycles and the associated risk that substantial time and resources may be spent on a potential end-customer that elects not to purchase our products and services.

Large enterprises often undertake a significant evaluation process that results in a lengthy sales cycle, in some cases over 12 months. Although we have a channel sales model, our sales representatives typically engage in direct interaction with our distributors and resellers in connection with sales to larger end-customers. Because these evaluations are often lengthy, with significant size and scope and stringent requirements, we typically provide evaluation products to these end-customers. We may spend substantial time, effort, and money in our sales efforts without being successful in generating any sales. In addition, product purchases by large enterprises are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing, and other delays. Finally, large enterprises typically have longer implementation cycles, require greater product functionality and scalability and a broader range of services, demand that vendors take on a larger share of risks, sometimes require acceptance provisions that can lead to a delay in revenue recognition, and expect greater payment flexibility from vendors. All of these factors can add further risk to business conducted with these end-customers. If we fail to realize an expected sale from a large end-customer in a particular quarter or at all, our business, operating results, and financial condition could be materially and adversely affected.

***We rely on revenue from subscription and support services, which may decline, and because we recognize revenue from subscriptions and support services over the term of the relevant service period, downturns or upturns in sales of these subscription and support services are not immediately reflected in full in our operating results.***

Services revenue accounts for a significant portion of our revenue, comprising 43% of total revenue in the nine months ended of April 30, 2014 and 37% of total revenue in the nine months ended of April 30, 2013. Sales of new or renewal subscription and support and maintenance contracts may decline and fluctuate as a result of a number of factors, including end-customers level of satisfaction with our products and services, the prices of our products and services, the prices of products and services offered by our competitors, and reductions in our end-customers spending levels. If our sales of new or renewal subscription and support and maintenance contracts decline, our revenue and revenue growth may decline and our business will suffer. In addition, we recognize subscription and support and maintenance revenue monthly over the term of the relevant service period, which is typically one year and can be up to five years. As a result, much of the subscription and support and maintenance revenue we report each fiscal quarter is the recognition of deferred revenue from subscription and support and maintenance contracts entered into during previous fiscal quarters. Consequently, a decline in new or renewed subscription or support and maintenance contracts in any one fiscal quarter will not be fully or immediately reflected in revenue in that fiscal quarter but will negatively affect our revenue in future fiscal quarters. Accordingly, the effect of significant downturns in new or renewed sales of our subscriptions or support and maintenance is not reflected in full in our operating results until future periods. Also, it is difficult for us to rapidly increase our services revenue through additional service sales in any period, as revenue from new and renewal service contracts must be recognized over the applicable service period. Furthermore, any increase in the average term of services contracts would result in revenue for services contracts being recognized over longer periods of time.

***Defects, errors, or vulnerabilities in our products or services or the failure of our products or services to block a virus or prevent a security breach could harm our reputation and adversely impact our results of operations.***

Because our products and services are complex, they have contained and may contain design or manufacturing defects or errors that are not detected until after their commercial release and deployment by our end-customers. For example, from time to time, certain of our end-customers have reported defects in our products related to performance, scalability, and compatibility that were not detected before shipping the product. Additionally, defects may cause our products or services to be vulnerable to security attacks, cause them to fail to help secure networks, or temporarily interrupt end-customers networking traffic. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques and provide a solution in time to protect our end-customers networks. Furthermore, as a well-known provider of enterprise security solutions, our networks, products, and services could be targeted by attacks specifically designed to disrupt our business and harm our reputation. In addition, defects or errors in our subscription updates or our products could result in a failure of our services to effectively update end-customers hardware products and thereby leave our end-customers vulnerable to attacks. Our data centers and networks may experience technical failures and downtime, may fail to distribute appropriate updates, or may fail to meet the increased requirements of a growing end-customer base, any of which could temporarily or permanently expose our end-customers networks, leaving their networks unprotected against the latest security threats.

Any defects, errors or vulnerabilities in our products could result in:

- expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate, or work-around errors or defects or to address and eliminate vulnerabilities;
- loss of existing or potential end-customers or channel partners;
- delayed or lost revenue;
- delay or failure to attain market acceptance;

- an increase in warranty claims compared with our historical experience, or an increased cost of servicing warranty claims, either of which would adversely affect our gross margins; and

- litigation, regulatory inquiries, or investigations that may be costly and harm our reputation.

***Our business is subject to the risks of warranty claims, product returns, product liability, and product defects.***

Our products are very complex and, despite testing prior to their release, they have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Product defects or errors could affect the performance of our products and could delay the development or release of new products or new versions of products, adversely affect our reputation and our end-customers willingness to buy products from us, and adversely affect market acceptance or perception of our products. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning the products, cause us to lose significant end-customers, subject us to liability for damages, and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations, and financial condition. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. For example, from time to time, certain of our end-customers have experienced temporary delays or interoperability issues when implementing our products in large complex global deployments where our products are required to interoperate with a complex environment of third party products. The occurrence of hardware or software errors, whether or not caused by our products, could delay or reduce market acceptance of our products, and have an adverse effect on our business and financial performance, and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems could harm our business, financial condition, and results of operations.

The limitation of liability provisions in our standard terms and conditions of sale may not fully or effectively protect us from claims as a result of federal, state, or local laws or ordinances, or unfavorable judicial decisions in the United States or other countries. The sale and support of our products also entails the risk of product liability claims. Although we may be indemnified by our third-party manufacturers for product liability claims arising out of manufacturing defects, because we control the design of our products, we may not be indemnified for product liability claims arising out of design defects. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover any claim asserted against us. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation, divert management s time and other resources, and harm our reputation.

***If the enterprise security market does not continue to adopt our enterprise security platform, our sales will not grow as quickly as anticipated, and the market price of our common stock could decline.***

We are seeking to disrupt the enterprise security market with our enterprise security platform. However, organizations that use legacy products and services for their enterprise security needs may believe that these products and services sufficiently achieve their purpose. Organizations may also believe that our products and services only serve the needs of a portion of the enterprise security market. Accordingly, organizations may continue allocating their IT budgets for legacy products and services and may not adopt our enterprise security platform. If the market for enterprise security solutions does not continue to adopt our enterprise security platform, if end-customers do not recognize the value of our platform compared to legacy products and services, or if we are otherwise unable to sell our products and services to organizations, then our revenue may not grow or may decline, which would have a material adverse effect on our operating results and financial condition.

***If we do not accurately predict, prepare for, and respond promptly to the rapidly evolving technological and market developments and changing end-customer needs in the enterprise security market, our competitive position and prospects will be harmed.***

The enterprise security market is expected to continue to evolve rapidly. Moreover, many of our end-customers operate in markets characterized by rapidly changing technologies and business plans, which require them to add numerous network access points and adapt increasingly complex enterprise networks, incorporating a variety of hardware, software applications, operating systems, and networking protocols. The technology in our products is especially complex because it needs to effectively identify and respond to new and increasingly sophisticated methods of attack, while minimizing the impact on network performance. Additionally, some of our new products and enhancements may require us to develop new hardware architectures that involve complex, expensive, and time-consuming research and development processes. Although the market expects rapid introduction of new products or product enhancements to respond to new threats, the development of these products is difficult and the timetable for commercial release and availability is uncertain as there can be long time periods between releases and availability of new products. We may experience unanticipated delays in the availability of new products and services and fail to meet customer expectations for such availability. If we do not quickly respond to the rapidly changing and rigorous needs of our end-customers by developing, releasing, and making available on a timely basis new products and services or enhancements that can respond adequately to new security threats, our competitive position and business prospects will be harmed.

Additionally, the process of developing new technology is complex and uncertain, and if we fail to accurately predict end-customers changing needs and emerging technological trends in the enterprise security industry, including the areas of mobility, virtualization, cloud computing, and software defined networks (SDN), our business could be harmed. We must commit significant resources to developing new products before knowing whether our investments will result in products the market will accept. The success of new products depends on several factors, including appropriate new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, or achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

***To remain competitive, we must successfully manage product introductions and transitions.***

Due to the highly volatile and competitive nature of the industries in which we compete, we must continually introduce new products, services and technologies, and enhance existing products and services. The success of new product introductions depends on a number of factors including, but not limited to, timely and successful product development, market acceptance, our ability to manage the risks associated with new product production ramp-up issues, the availability of application software for new products, the effective management of purchase commitments and inventory in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, we cannot determine in advance the ultimate effect of new product introductions and transitions on our business and results of operations.

***Our current research and development efforts may not produce successful products or features that result in significant revenue, cost savings or other benefits in the near future, if at all.***

Developing our products and related enhancements is expensive. Our investments in research and development may not result in significant design improvements, marketable products or features, or may result in products that are more expensive than anticipated. Additionally, we may not achieve the cost savings or the anticipated performance improvements we expect, and we may take longer to generate revenue, or generate less revenue, than we anticipate. Our future plans include significant investments in research and development and related product opportunities. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we may not receive significant revenue from these investments in the near future, if at all, or these investments may not yield the expected benefits, either of which could adversely affect our business and operating results.

***The sales prices of our products and services may decrease, which may reduce our gross profits and adversely impact our financial results.***

The sales prices for our products and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and services, anticipation of the introduction of new products or services, or promotional programs. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product and service offerings may reduce the price of

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products or services that compete with ours or may bundle them with other products and services. Additionally, although we price our products and services worldwide in U.S. dollars, currency fluctuations in certain countries and regions may negatively impact actual prices that partners and end-customers are willing to pay in those countries and regions. Furthermore, we anticipate that the sales prices and gross profits for our products will decrease over product life cycles. We cannot assure you that we will be successful in developing and introducing new offerings with enhanced functionality on a timely basis, or that our product and service offerings, if introduced, will enable us to maintain our prices and gross profits at levels that will allow us to achieve and maintain profitability.

***We generate a significant amount of revenue from sales to distributors, resellers, and end-customers outside of the United States, and we are therefore subject to a number of risks associated with international sales and operations.***

We have a limited history of marketing, selling, and supporting our products and services internationally. As a result, we must hire and train experienced personnel to staff and manage our foreign operations. To the extent that we experience difficulties in recruiting, training, managing, and retaining an international staff, and specifically staff related to sales management and sales personnel, we may experience difficulties in sales productivity in foreign markets. We also enter into strategic distributor and reseller relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited. Business practices in the international markets that we serve may differ from those in the United States and may require us in the future to include terms other than our standard terms in customer contracts. To the extent that we may enter into customer contracts in the future that include non-standard terms related to payment, warranties, or performance obligations, our operating results may be adversely impacted.

Additionally, our international sales and operations are subject to a number of risks, including the following:

- economic uncertainty around the world, in particular, macroeconomic challenges in Europe;
- greater difficulty in enforcing contracts and accounts receivable collection and longer collection periods;
- the uncertainty of protection for intellectual property rights in some countries;
- greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;
- risks associated with trade restrictions and foreign legal requirements, including the importation, certification, and localization of our products required in foreign countries;
- greater risk of a failure of foreign employees, partners, distributors, and resellers to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act, U.S. or foreign sanctions regimes and export or import control laws, and any trade regulations ensuring fair trade practices;

heightened risk of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, or irregularities in, financial statements;

increased expenses incurred in establishing and maintaining office space and equipment for our international operations;

greater difficulty in recruiting local experienced personnel, and the costs and expenses associated with such activities;

management communication and integration problems resulting from cultural and geographic dispersion;

- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business; and

- general economic and political conditions in these foreign markets.

These factors and other factors could harm our ability to gain future international revenues and, consequently, materially impact our business, operating results, and financial condition. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. Our failure to successfully manage our international operations and the associated risks effectively could limit the future growth of our business.

***We are exposed to the credit and liquidity risk of some of our channel partners and to credit exposure in weakened markets, which could result in material losses.***

For the nine months ended of April 30, 2014, three channel partners represented 69% of our total revenue, and as of April 30, 2014, three channel partners represented 66% of our gross accounts receivable. Most of our sales to our channel partners are made on an open credit basis. Although we have programs in place that are designed to monitor and mitigate these risks, we cannot assure you these programs will be effective in reducing our credit risks, especially as we expand our business internationally. If we are unable to adequately control these risks, our business, operating results, and financial condition could be harmed.

***A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.***

Sales to U.S. and foreign, federal, state, and local governmental agency end-customers have accounted for an increasingly significant amount of our revenue, and we may in the future increase sales to government entities. Sales to government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive, and time-consuming, often requiring significant upfront time and expense without any assurance that these efforts will generate a sale. Government certification requirements for products like ours may change, thereby restricting our ability to sell into the federal government sector until we have attained the revised certification. Government demand and payment for our products and services may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products and services. For example, spending on enterprise security by various agencies of the U.S. government may be reduced as a result of sequestration, which could adversely impact our business and operating results. In addition, the U.S. Congress may take additional action in 2014 to further reduce federal spending and the deficit which could further impact our business and operating results.

The substantial majority of our sales to date to government entities have been made indirectly through our channel partners. Government entities may have statutory, contractual, or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors administrative processes, and any unfavorable audit could result in the government refusing to continue buying our products and services, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities, which could adversely impact our operating results in a material way. Finally, for purchases by the U.S. government, the government may require certain products to be /TD> 390,978

Proceeds from issuance of warrants

38,278

Purchase of convertible note hedge

(85,853)

Other financing activities

(919)

Proceeds from exercise of options to purchase common stock

9,640 22,827

Excess tax benefit from stock-based compensation

8,161 2,583

Net cash provided by financing activities

17,801 367,894

Effect of exchange rate changes on cash and cash equivalents

(9,354) (5,303)

Net increase (decrease) in cash and cash equivalents

8,968 (32,505)

Cash and cash equivalents at beginning of period

292,325 324,608

Cash and cash equivalents at end of period

$301,293 $292,103

Cash paid for interest

$503 $253

Cash paid for taxes, net of refunds

$2,091 $3,727

**Supplemental disclosure of non-cash activities**

Changes to accrued capital expenditures

$2,455 $

Changes to redemption value of noncontrolling interests

$914 $851

The accompanying notes are an integral part of these financial statements.

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**HomeAway, Inc.**

**Notes to Condensed Consolidated Financial Statements (unaudited)**

## 1. Description of Business

HomeAway, Inc. (the Company ) operates an online vacation rental property marketplace that enables property owners and managers to market properties available for rental to vacation travelers who rely on the Company s websites to search for and find available properties. Property owners and managers pay listing fees to provide detailed listings of their properties on the Company s websites and reach a broad audience of travelers seeking vacation rentals. Listing fees are typically annual subscriptions or payments on a performance basis, based on bookings or inquiries made by travelers to property owners and managers. A listing includes published detailed property information, including photographs, descriptions, location, pricing, availability and contact information. The Company also sells, directly or through third parties, complementary products, including travel guarantees, insurance products and property management software and services. Travelers use the network of websites to search for vacation rentals meeting their desired criteria, including location, size and price. Travelers that find properties meeting their requirements through the Company s marketplace are able to make reservations online or contact property owners and managers directly by phone or through form-based communication tools on the Company s websites.

The Company is a Delaware corporation headquartered in Austin, Texas.

## 2. Summary of Significant Accounting Policies

***Basis of Presentation***

The accompanying condensed consolidated financial statements include the accounts of HomeAway, Inc. and its wholly and majority-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial reporting and applicable quarterly reporting regulations of the Securities and Exchange Commission, (the SEC ). All significant intercompany transactions and balances have been eliminated in consolidation. In the opinion of the Company s management, the accompanying interim unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of normal recurring adjustments and those items discussed in these notes, necessary for a fair statement of the Company s financial position, as of September 30, 2015 and December 31, 2014, results of operations for the three and nine months ended September 30, 2015 and September 30, 2014, comprehensive income (loss) for the three and nine months ended September 30, 2015 and September 30, 2014, cash flows for the nine months ended September 30, 2015 and September 30, 2014, and changes in stockholders equity for the nine months ended September 30, 2015. Certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with GAAP have been omitted from these interim condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2014. Operating results for this interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2015, or for any other period.

***Business Segment***

The Company has one operating segment consisting of various products and services related to its online marketplace of accommodation rental listings. The Company s chief operating decision maker is the Chief Executive Officer. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the single operating segment level.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. These differences could have a material effect on the Company s future results of operations and financial position. Significant items subject to estimates and assumptions include certain revenues, traveler guarantees, the allowance for doubtful accounts, marketable and non-marketable investments, goodwill and other indefinite-lived intangible assets, definite-lived intangible assets, depreciation and amortization, stock-based compensation, deferred income taxes and noncontrolling interests.

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***Fair Value of Financial Instruments***

Fair value is defined as the price received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the comparability of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

| | |
|---|---|
| Level 1: | Valuations based on quoted prices for identical assets and liabilities in active markets. |
| Level 2: | Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data. |
| Level 3: | Valuations based on unobservable inputs reflecting the Company s assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment. |

The Company s financial instruments classified as Level 1 are valued using quoted prices generated by market transactions involving identical assets. Instruments classified as Level 2 are valued using non-binding market consensus prices corroborated with observable market data; quoted market prices for similar instruments in active markets; or pricing models, such as a discounted cash flow model, with significant inputs derived from or corroborated with observable market data. The Company did not hold financial instruments categorized as Level 3 in any period presented.

Short-term investments are classified as available-for-sale and reported at fair value using the specific identification method. Unrealized gains and losses are excluded from earnings and reported as a component of other comprehensive income (loss), net of tax. Additionally, the Company periodically assesses whether an other than temporary impairment loss on investments has occurred due to declines in fair value or other market conditions. Declines in fair value considered other-than-temporary are recorded as an impairment in the condensed consolidated statement of operations. The Company did not record impairments of its investments during any of the periods presented.

The carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued liabilities and deferred revenue approximate fair value because of the relatively short maturity of these instruments.

The following table summarizes the basis used to measure certain financial assets at fair value on a recurring basis in the Company s condensed consolidated balance sheet at September 30, 2015 (in thousands):

| | **Balance as of September 30, 2015** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
|---|---|---|---|---|
| **Assets:** | | | | |
| Cash equivalents | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Money market funds | $ | 151,691 | $ | 151,691 | $ | | $ | |
| Total cash equivalents | | 151,691 | | 151,691 | | | | |
| Restricted cash | | | | | | | | |
| Time deposits | | 1,983 | | | | 1,983 | | |
| Total restricted cash | | 1,983 | | | | 1,983 | | |
| Short-term investments | | | | | | | | |
| U.S. government agency bonds | | 23,339 | | | | 23,339 | | |
| Time deposits | | 39,529 | | | | 39,529 | | |
| Corporate bonds | | 346,782 | | | | 346,782 | | |
| International government bonds | | 21,390 | | | | 21,390 | | |
| Municipal bonds | | 187,303 | | | | 187,303 | | |
| Total short-term investments | | 618,343 | | | | 618,343 | | |
| Total financial assets | $ | 772,017 | $ | 151,691 | $ | 620,326 | $ | |

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The following table summarizes the basis used to measure certain financial assets at fair value on a recurring basis in the Company s condensed consolidated balance sheet at December 31, 2014 (in thousands):

| | Balance as of December 31, 2014 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Assets:** | | | | |
| Cash equivalents | | | | |
| Money market funds | $ 183,008 | $ 183,008 | $ | $ |
| Municipal bonds | 1,001 | | 1,001 | |
| Total cash equivalents | 184,009 | 183,008 | 1,001 | |
| Restricted cash | | | | |
| Time deposits | 2,058 | | 2,058 | |
| Total restricted cash | 2,058 | | 2,058 | |
| Short-term investments | | | | |
| Time deposits | 21,726 | | 21,726 | |
| Corporate bonds | 353,212 | | 353,212 | |
| International government bonds | 1,501 | | 1,501 | |
| Municipal bonds | 140,406 | | 140,406 | |
| Commercial paper | 3,999 | | 3,999 | |
| Total short-term investments | 520,844 | | 520,844 | |
| Total financial assets | $ 706,911 | $ 183,008 | $ 523,903 | $ |

***Cash and Cash Equivalents***

Cash and cash equivalents include investments in demand deposits, money market funds, and municipal bonds readily convertible into cash. Cash and cash equivalents are stated at cost, which approximates fair value. The Company considers all highly liquid investments purchased with an original maturity date of three months or less to be cash equivalents. Cash and cash equivalents consisted of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Demand deposit accounts | $ 149,602 | $ 108,316 |
| Money market funds | 151,691 | 183,008 |
| Municipal bonds | | 1,001 |
| Total cash and cash equivalents | $ 301,293 | $ 292,325 |

***Restricted Cash***

Restricted cash of $2,200,000 and $2,492,000 at September 30, 2015 and December 31, 2014, respectively, was held in accounts owned by the Company to secure property licenses, leased office space, credit card availability and reimbursable direct debits due from the Company. Restricted cash is recorded as Other non-current assets on the Company s condensed consolidated balance sheets.

***Short-term Investments***

Short-term investments generally consist of marketable securities with original maturities greater than ninety days as of the date of purchase. Investments in which the Company has the ability and intent, if necessary, to liquidate in order to support its current operations, including those with contractual maturities greater than one year from the date of purchase, are classified as short-term. The Company s investment securities are classified as available-for-sale and presented at estimated fair value with any unrealized gains and losses included in other comprehensive income (loss).

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Cash flows from purchases, sales and maturities of available-for-sale securities are classified as investing activities and reported gross, including any related premiums or discounts. Premiums related to purchases of available-for-sale securities were $9,240,000 and $11,239,000 during the nine months ended September 30, 2015 and 2014, respectively. Short-term investments consisted of the following (in thousands):

| | September 30, 2015 | | | |
|---|---|---|---|---|
| | Gross Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S government agency bonds | $ 23,375 | $ 3 | $ (39) | $ 23,339 |
| Time deposits | 39,529 | | | 39,529 |
| Corporate bonds | 346,949 | 141 | (308) | 346,782 |
| International government bonds | 21,418 | | (28) | 21,390 |
| Municipal bonds | 187,254 | 83 | (34) | 187,303 |
| Total short-term investments | $ 618,525 | $ 227 | $ (409) | $ 618,343 |

| | December 31, 2014 | | | |
|---|---|---|---|---|
| | Gross Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Time deposits | $ 21,726 | $ | $ | $ 21,726 |
| Corporate bonds | 353,957 | 7 | (752) | 353,212 |
| International government bonds | 1,504 | | (3) | 1,501 |
| Municipal bonds | 140,455 | 45 | (94) | 140,406 |
| Commercial paper | 3,999 | | | 3,999 |
| Total short-term investments | $ 521,641 | $ 52 | $ (849) | $ 520,844 |

For fixed income securities with unrealized losses as of September 30, 2015, the Company does not intend to sell any of these investments; and the Company expects it will not be required to sell any of these investments before recovery of the entire amortized cost basis. The Company has evaluated these fixed income securities and determined that no credit losses exist. Accordingly, the Company has determined that the unrealized losses on fixed income securities as of September 30, 2015 were temporary in nature.

The following table summarizes the contractual underlying maturities of the Company s short-term investments (in thousands):

| | September 30, 2015 | | |
|---|---|---|---|
| | Less than 1 Year | 1 to 3 Years | Total |
| U.S government agency bonds | $ 597 | $ 22,742 | $ 23,339 |
| Time deposits | 25,951 | 13,578 | 39,529 |

| | | | |
|---|---|---|---|
| Corporate bonds | 203,039 | 143,743 | 346,782 |
| International government bonds | 15,192 | 6,198 | 21,390 |
| Municipal bonds | 131,167 | 56,136 | 187,303 |
| Total short-term investments | $ 375,946 | $ 242,397 | $ 618,343 |

| | December 31, 2014 | | |
|---|---|---|---|
| | Less than 1 Year | 1 to 3 Years | Total |
| Time deposits | $ 21,479 | $ 247 | $ 21,726 |
| Corporate bonds | 240,570 | 112,642 | 353,212 |
| International government bonds | 1,501 | | 1,501 |
| Municipal bonds | 87,615 | 52,791 | 140,406 |
| Commercial paper | 3,999 | | 3,999 |
| Total short-term investments | $ 355,164 | $ 165,680 | $ 520,844 |

***Non-marketable Cost Investments***

During the nine months ended September 30, 2015, the Company invested $2,799,000 for a non-controlling equity interest in a privately-held vacation rental website company in Canada and $2,000,000 for a non-controlling equity interest in a privately-held vacation rental website company in Turkey. The Company also has a non-controlling equity interest in a privately-held company in China with a carrying value of $19,498,000 and a non-controlling equity investment with a carrying value of $15,000,000 in a privately-held company in the United States that operates a travel research application and website.

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The Company s investment in these privately-held companies is reported using the cost method of accounting and adjusted to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. No event or circumstance indicating an other-than-temporary decline in value of the Company s interest in the non-marketable cost investments has been identified during any of the periods presented.

***Accounts Receivable***

Accounts receivable are generated from credit card merchants who process the Company s property listing sales, property listings sold on installments to the Company s customers, partners who advertise the Company s inventory on their websites and/or sell ancillary products to the Company s customers and Internet display advertising. Accounts receivable outstanding beyond the contractual payment terms are considered past due. The Company determines its allowance for doubtful accounts by estimating losses on receivables based on known troubled accounts and historical experiences of losses incurred.

***Property and Equipment***

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Computer equipment and purchased software are generally depreciated over three years. Furniture and fixtures are generally depreciated over five to ten years. Leasehold improvements are depreciated over the shorter of the contractual lease period or estimated useful life. Upon disposal, property and equipment and the related accumulated depreciation are removed and the resulting gain or loss is reflected in the condensed consolidated statements of operations. Ordinary maintenance and repairs are charged to expense, while expenditures that extend the physical or economic life of the assets are capitalized.

The Company capitalizes certain internally developed software and website development costs. These capitalized costs were approximately $38,759,000 and $36,038,000 at September 30, 2015 and December 31, 2014, respectively, and are included in property and equipment, net, in the condensed consolidated balance sheets. Internally developed software costs are generally depreciated over five years.

The Company recorded depreciation expense on internally developed software and website development costs as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Depreciation expense on internally developed software and website development costs | $ 1,677 | $ 1,343 | $ 4,867 | $ 3,947 |

***Goodwill and Intangible Assets***

Goodwill arises from business combinations and is measured as the excess of the purchase consideration over the sum of the acquisition-date fair values of tangible and identifiable intangible assets acquired, less any liabilities assumed. The Company uses estimates and assumptions to value assets acquired and liabilities assumed at the acquisition date, and these estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, adjustments to the assets acquired and liabilities assumed are recorded with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the condensed consolidated statements of operations.

Goodwill and intangible assets deemed to have indefinite useful lives, such as certain trade names, are not amortized. Tests for impairment of goodwill and indefinite-lived intangible assets are performed on an annual basis or when events or circumstances indicate that the carrying amount may not be recoverable.

Circumstances that could trigger an impairment test outside of the annual test include but are not limited to: a significant adverse change in the business climate or legal factors, adverse cash flow trends, an adverse action or assessment by a regulator, unanticipated competition, loss of key personnel, decline in stock price and the results of tests for recoverability of a significant asset group. The Company has determined that no triggering event occurred during any of the periods presented.

For goodwill and indefinite-lived intangible assets, the Company completes a Step 0 analysis, which involves evaluating qualitative factors, including macroeconomic conditions, industry and market considerations, cost factors and overall financial performance related to its goodwill and its indefinite-lived intangible assets. If the Company s Step 0 analysis indicates that it is more likely than not that the fair value of a reporting unit or of an indefinite-lived intangible asset is less than its carrying amount, then the Company would perform a quantitative two-step impairment test. The quantitative analysis compares the fair value of the Company s reporting unit or indefinite-lived intangible assets to its carrying amount, and an impairment loss is recognized equivalent to the excess of the carrying amount over fair value. If, after assessing the totality of events or circumstances, the Company determines that it is more likely than not that the fair value of a reporting unit or indefinite-lived intangible asset exceeds its carrying amount, then the quantitative impairment tests are unnecessary.

The Company performs an evaluation of goodwill and indefinite-lived intangible assets for impairment annually in the fourth quarter of its fiscal year.

The determination of whether or not goodwill or indefinite-lived intangible assets have become impaired involves a significant level of judgment. Changes in the Company s strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded amounts of goodwill or indefinite-lived intangible assets.

No impairment of goodwill or indefinite-lived intangible assets was identified in any of the periods presented.

Identifiable intangible assets consist of trade names, customer relationships, developed technology, domain names and contractual non-competition agreements associated with acquired businesses. Intangible assets with finite lives are amortized over their estimated useful lives on a straight-line basis and reviewed for impairment whenever events or changes in circumstances indicate that an asset s carrying value may not be recoverable (see Note 3). The straight-line method of amortization represents the Company s best estimate of the distribution of the economic value of the identifiable intangible assets.

***Impairment of Long-lived Assets***

The Company evaluates long-lived assets held for use, such as property and equipment, for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated future undiscounted cash flows expected from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value in the period in which the determination is made. No material impairments of long-lived assets have been recorded during any of the periods presented.

***Leases***

The Company leases facilities in several countries around the world and certain equipment under non-cancelable lease agreements. The terms of certain lease agreements provide for rental payments on a graduated basis. Rent expense is recognized on a straight-line basis over the lease period and accrued as rent expense incurred but not paid.

***Revenue Recognition***

The Company recognizes revenue when persuasive evidence of an agreement exists, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured. The Company accounts for sales incentives to customers as a reduction of revenue at the time revenue is recognized from the related product sale. The Company also reports revenue net of any sales taxes collected.

The Company generates a significant portion of its revenue from customers purchasing online advertising services related to the listing of their properties for rent, primarily on a subscription basis over a fixed-term. The Company also generates revenue based on the number of traveler inquiries and reservation bookings for property listings on the Company s websites, local and national Internet display advertisers, license of property management software and ancillary products and services.

Payments for term-based subscriptions received in advance of services rendered are recorded as deferred revenue and recognized on a straight-line basis over the listing period.

Revenue for inquiry-based contracts are determined on a fixed fee-per-inquiry basis as stated in the arrangement and recognized when the service has been performed.

The Company earns commission revenue for reservations made online through its websites, which is calculated as a percentage of the value of the reservation. This revenue is earned as the services are performed or as the customers refund privileges lapse and is included in listing revenue in the condensed consolidated statements of operations.

Internet display advertising revenue is generated primarily from advertisements appearing on the Company s websites. Depending upon the terms, revenue is earned each time an impression is delivered, a user clicks on an ad, a graphic ad is displayed, or a user clicks-through the ad and takes a specified action on the destination site.

The Company sells gift cards with no expiration date to travelers and does not charge administrative fees on unused cards. There is a portion of the gift card obligation that, based on historical redemption patterns, will not be used by the Company s customers and

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is not required to be remitted to relevant jurisdictions ( breakage ). At the point of sale, the Company recognizes estimated breakage as deferred revenue and amortizes it over 48 months based on historical redemption patterns. The Company also records commission revenue for each gift card sale over the same 48-month redemption period.

Through its professional software for bed and breakfasts and professional property managers, the Company also makes selected, online bookable properties available to online travel agencies and channel partners. The Company receives a percentage of the transaction value or a fee from the property manager for making this inventory available, which is recognized when earned. This revenue is included in other revenue in the condensed consolidated statements of operations.

The Company generates revenue from the sale of hosted software solutions where revenue is recognized on a straight-line basis over the contract term, generally one year. Certain implementation services are essential to the customer s use of the Company s hosted software solutions. Accordingly, the Company recognizes implementation revenue ratably over the estimated period of the hosting relationship, which is three years. Recognition starts once the product has been made available to the customer.

Training and consulting revenue is recognized upon delivery of the training or consulting services to the end customer.

***Stock-Based Compensation***

Stock-based compensation for option awards is recognized based upon the estimated grant date fair value of the awards measured using the Black Scholes valuation model. The fair value of restricted stock awards is determined based on the number of shares granted and the fair value of the Company s common stock on the grant date. Fair value is generally recognized as an expense on a straight-line basis, net of estimated forfeitures, over the requisite service period. When estimating forfeitures, the Company considers voluntary termination behaviors as well as trends of actual option forfeitures.

The Company uses the with and without approach in determining the order in which tax attributes are utilized. As a result, the Company only recognizes a tax benefit from stock-based awards in additional paid-in capital if an incremental tax benefit is realized after all other tax attributes currently available to the Company have been utilized. When tax deductions from stock-based awards are less than the cumulative book compensation expense, the tax effect of the resulting difference is charged first to additional paid-in capital to the extent of the Company s pool of windfall tax benefits with any remainder recognized in income tax expense. The Company has determined that it has a sufficient windfall pool available and therefore no amounts have been recognized as income tax expense. In addition, the Company accounts for the indirect effects of stock-based awards on other tax attributes through the condensed consolidated statements of operations.

The gross benefits of tax deductions in excess of recognized compensation costs are reported as financing cash inflows, but only when such excess tax benefits are realized by a reduction to current taxes payable.

The following table summarizes the excess tax benefit that the Company recorded (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| | $ 5,200 | $ 1,362 | $ 7,494 | $ 2,583 |

| |
|---|
| Excess tax benefit from stock-based compensation, net |

This tax benefit has been recorded as additional paid-in capital on the Company s condensed consolidated balance sheets.

***Defined Benefit Pension Plan***

During the nine months ended September 30, 2015, the Company recorded an adjustment to correct a prior period accounting error related to the Company s defined benefit pension plan for one of its foreign subsidiaries. The adjustment increased the Company s liabilities by approximately $4,200,000 and decreased other comprehensive income by approximately $4,000,000 and income before income taxes by approximately $200,000 as of and during the nine months ended September 30, 2015. The Company does not believe these adjustments are material to the consolidated financial statements for the three and nine months ended September 30, 2015, the expected annual results for 2015 or to the consolidated financial statements of any prior period.

***Income Taxes***

The Company recognizes income taxes using an asset and liability approach. This approach requires the recognition of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company s consolidated financial statements or tax returns. The measurement of deferred taxes is based on provisions of the enacted tax law and the effects of future changes in tax laws or rates are not anticipated. A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Evaluating the need for an amount of a valuation allowance for deferred tax assets requires significant judgment and analysis of the positive and negative evidence available, including past operating results, estimates of future taxable income, reversals of existing taxable temporary differences and the feasibility of tax planning in order to determine whether all or some portion of the deferred tax assets will not be realized. Based on the available evidence and judgment, the Company has determined that it is more likely than not that certain loss carryforwards will not be realized; therefore, the Company has established a valuation allowance for such deferred tax assets to reduce the loss carryforward assets to amounts expected to be utilized.

The Company may be subject to income tax audits by the respective tax authorities in any or all of the jurisdictions in which the Company operates. The Company is currently undergoing audits in the United States as well as at its subsidiary in the United Kingdom. Significant judgment is required in determining uncertain tax positions. The Company recognizes the benefit of uncertain income tax positions only if these positions are more likely than not to be sustained. Also, the recognized income tax benefit is measured at the largest amount that is more than 50% likely of being realized. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of an audit or the refinement of an estimate. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits as a component of income tax expense. The countries in which the Company may be subject to potential examination by tax authorities include Australia, Brazil, Colombia, France, Germany, Italy, the Netherlands, New Zealand, Singapore, Spain, Switzerland, Thailand, the United Kingdom and the United States.

The calculation of the Company s tax liabilities involves the inherent uncertainty associated with the application of complex tax laws. As a multinational corporation, the Company conducts its business in many countries and is subject to taxation in many jurisdictions. The taxation of the Company s business is subject to the application of various and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The Company s effective tax rate is highly dependent upon the geographic distribution of its worldwide earnings or losses, the tax regulations and tax rates in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of its tax planning strategies. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation, and the evolution of regulations and court rulings. Consequently, taxing authorities may impose tax assessments or judgments against the Company that could materially impact its tax liability and/or its effective income tax rate. The Company believes it has adequately provided in its financial statements for additional taxes that it estimates may be assessed by the various taxing authorities. While the Company believes that it has adequately provided for all uncertain tax positions, amounts asserted by tax authorities could be greater or less than the Company s accrued position. These tax liabilities, including the interest and penalties, are adjusted pursuant to a settlement with tax authorities, completion of audit, refinement of estimates or expiration of various statutes of limitation.

***Foreign Currency***

The functional currency of the Company s foreign subsidiaries is generally their respective local currency. The financial statements of the Company s international operations are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders equity, and a weighted average exchange rate for each period for revenue, expenses, gains and losses. Foreign currency translation adjustments are recorded as a separate component of stockholders equity. Gains and losses from non-functional currency denominated transactions are recorded in other income (expense) in the Company s condensed consolidated statements of operations.

The following table summarizes the foreign exchange loss that the Company recorded (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Foreign exchange loss | $ 279 | $ 1,432 | $ 930 | $ 6,421 |

***Derivative Financial Instruments***

As a result of the Company s international operations, it is exposed to various market risks that may affect its consolidated results of operations, cash flows and financial position. These market risks include, but are not limited to, fluctuations in currency exchange rates. The Company s primary foreign currency exposures are in Euros, British Pounds, Brazilian Real, Australian Dollars, Singapore Dollars and New Zealand Dollars. As a result, the Company faces exposure to adverse movements in currency exchange rates as the financial results of its operations are translated from local currency into U.S. dollars. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in gains and losses that are reflected in other income (expense) in the Company s condensed consolidated statements of operations.

The Company may enter into derivative instruments to hedge certain net exposures of nonfunctional currency denominated assets and liabilities, primarily related to intercompany loans, even though it does not elect to apply hedge accounting or hedge

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accounting does not apply. Gains and losses resulting from a change in fair value for these derivatives are reflected in the period in which the change occurs and are recognized on the condensed consolidated statement of operations in other income (expense). Cash flows from these contracts are classified within cash flows from investing activities on the condensed consolidated statements of cash flows.

The Company does not use financial instruments for trading or speculative purposes. The Company recognizes all derivative instruments on the balance sheet at fair value and its derivative instruments are generally short-term in duration. The Company is exposed to the risk that counterparties to derivative contracts may fail to meet their contractual obligations.

The following table shows the fair value and notional amounts of the Company s outstanding or unsettled derivative instruments that are not designated as hedging instruments covering foreign currency exposures as of September 30, 2015 which settled October 2, 2015 (in thousands):

| | September 30, 2015 Significant Other Observable Inputs (Level 2) | | | |
|---|---|---|---|---|
| | Gross Amount of Recognized Assets/Liabilities | Gross Amounts Offset in the Balance Sheet | Net Amount Presented in the Balance Sheet | U.S. Dollar Notional |
| Prepaid expense and other current assets | $ 1,173 | $ | $ 1,173 | $ 41,301 |
| Accrued expenses | (656) | | (656) | 129,303 |
| Total | $ 517 | $ | $ 517 | $ 170,604 |

In addition to the notional amounts listed above, the Company entered into new derivative contracts with notional amounts of $157,735,000 on September 30, 2015 with a closing date of January 5, 2016.

The following table shows the fair value and notional amounts of the Company s outstanding or unsettled derivative instruments that are not designated as hedging instruments covering foreign currency exposures as of December 31, 2014 which settled January 2, 2015 (in thousands):

| | December 31, 2014 Significant Other Observable Inputs (Level 2) | | | |
|---|---|---|---|---|
| | Gross Amount of Recognized Assets/Liabilities | Gross Amounts Offset in the Balance | Net Amount Presented in the Balance Sheet | U.S. Dollar Notional |

| | Sheet | | | |
|---|---|---|---|---|
| Prepaid expense and other current assets | $ 4,506 | $ | $ 4,506 | $ 157,164 |
| Accrued expenses | (67) | | (67) | 11,562 |
| Total | $ 4,439 | $ | $ 4,439 | $ 168,726 |

***Net Income Per Share Attributable to HomeAway, Inc.***

Basic net income per share is computed by dividing net income attributable to HomeAway, Inc. by the weighted average number of common shares outstanding during the period. Diluted income per share is computed by dividing net income attributable to HomeAway, Inc. by the weighted average common shares outstanding plus potentially dilutive common shares. The dilutive effect of outstanding options, warrants and awards is reflected in diluted earnings per share by application of the treasury stock method.

Restricted stock awards provide the holder of unvested shares the right to participate in dividends declared on the Company s common stock. Accordingly, these shares are included in the weighted average shares outstanding for the computation of basic earnings per share in periods of undistributed earnings. Restricted stock awards are excluded from the basic earnings per share in periods of undistributed losses as the holders are not contractually obligated to participate in the losses of the Company. Unvested restricted stock units do not provide the holder the right to participate in dividends declared on the Company s common stock. Accordingly, these shares are excluded in the weighted average shares outstanding for the computation of basic earnings per share in periods of undistributed earnings or losses.

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### *Comprehensive Income (Loss) Attributable to HomeAway, Inc.*

Comprehensive income (loss) attributable to HomeAway, Inc. consists of net income (loss), foreign currency translation adjustments, unrealized gain (loss) on short-term investments, defined benefit pension plan adjustments and comprehensive loss attributable to noncontrolling interests.

### *Recent Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. In July 2015, the FASB voted to defer the effective date to fiscal years, and interim reporting periods within those years, beginning after December 15, 2017. Early adoption is permitted. The Company has not yet selected a transition method and is currently evaluating the effect the updated standard will have on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, which changes the presentation of debt issuance costs in financial statements. The updated standard requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effect the updated standard will have on its consolidated balance sheets.

In April 2015, the FASB issued ASU No. 2015-05, Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. This standard clarifies whether a customer should account for a cloud computing arrangement as an acquisition of a software license or as a service arrangement by providing characteristics that a cloud computing arrangement must have in order to be accounted for as a software license acquisition. This guidance is effective for annual periods beginning after December 15, 2015. Early adoption is permitted. Upon adoption, an entity may apply the new guidance prospectively or retrospectively to all prior periods presented in the financial statements. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In September 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined, including the effects on current-period income that would have been recognized in previous periods if the adjustments were recognized as of the acquisition date. The new standard is effective for fiscal years, and interim period within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effect that the update standard will have on its consolidated financial statements and related disclosures.

## 3. Goodwill and Other Intangible Assets

### *Goodwill*

Changes in the Company s goodwill balance are summarized in the table below (in thousands):

| | |
|---|---|
| Balance at December 31, 2013 | $ 507,611 |
| Acquired in business combinations | 11,647 |
| Foreign currency translation adjustment | (26,098) |
| Post-acquisition goodwill adjustment for Stayz | 511 |
| Balance at December 31, 2014 | 493,671 |
| Foreign currency translation adjustment | (33,622) |
| Balance at September 30, 2015 | $ 460,049 |

The goodwill arising from the December 2013 acquisition of Stayz was increased by $511,000 to $178,288,000 in the year ended December 31, 2014 due to certain income taxes and changes in fair value estimates derived from additional information gained during the measurement period. Goodwill adjustments were not significant to the Company s previously reported operating results or financial position. Therefore, the Company elected not to retrospectively adjust the acquisition date accounting and instead recorded the adjustment in the year ended December 31, 2014.

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***Intangible Assets***

The Company s intangible assets, excluding goodwill, primarily consist of assets acquired in business combinations and are recorded at estimated fair value on the date of acquisition. The Company s finite-lived intangible assets are summarized in the table below (in thousands):

| | | September 30, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|---|
| | **Useful Life (Years)** | **Gross Carrying Amount** | **Accumulated Amortization** | **Net Carrying Amount** | **Gross Carrying Amount** | **Accumulated Amortization** | **Net Carrying Amount** |
| Trade names and trademarks | 10 | $ 28,525 | $ (9,572) | $ 18,953 | $ 30,316 | $ (8,396) | $ 21,920 |
| Developed technology | 2-8 | 20,290 | (14,748) | 5,542 | 21,293 | (13,231) | 8,062 |
| Customer relationships | 6-14 | 53,436 | (27,650) | 25,786 | 57,656 | (25,512) | 32,144 |
| Noncompete agreements and domain names | 2-5 | 1,949 | (1,256) | 693 | 2,224 | (923) | 1,301 |
| Total | | $ 104,200 | $ (53,226) | $ 50,974 | $ 111,489 | $ (48,062) | $ 63,427 |

Amortization of noncompete agreements is recorded over the term of the agreements.

The following table summarizes amortization expense (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Amortization expense | $ 2,819 | $ 3,397 | $ 8,713 | $ 10,163 |

The Company has the following indefinite-lived intangible assets recorded in its consolidated balance sheet (in thousands):

| | **September 30, 2015** | **December 31, 2014** |
|---|---|---|
| Trade names | $ 7,029 | $ 7,029 |

**4. Accrued Expenses**

The Company s accrued expenses are comprised of the following (in thousands):

| | **September 30, 2015** | **December 31, 2014** |
|---|---|---|
| Compensation and related benefits | $ 19,591 | $ 21,413 |

| | | | | |
|---|---|---|---|---|
| Taxes | | 6,810 | | 4,954 |
| Marketing | | 5,131 | | 4,115 |
| Gift cards | | 4,103 | | 5,654 |
| Contracting, consulting and professional fees | | 3,111 | | 3,254 |
| Traveler guarantee | | 1,246 | | 1,790 |
| Foreign exchange-forward contracts | | 683 | | 99 |
| Other | | 9,771 | | 8,976 |
| Total | $ | 50,446 | $ | 50,255 |

## 5. Convertible Senior Notes

***Convertible Senior Notes***

| **(In thousands)** | **Par Value** | **Equity Component Recorded at Issuance** | **Carrying Value of Convertible Senior Notes as of September 30, 2015** | **December 31, 2014** |
|---|---|---|---|---|
| 0.125% Convertible Senior Notes due April 1, 2019 | $ 402,500 | $ 90,887[(1)] | $ 329,905 | $ 316,181 |

(1) This amount represents the equity component recorded at the initial issuance of the 0.125% convertible senior notes.

In March 2014, the Company issued at par value $402.5 million of 0.125% convertible senior notes (the Notes ) due April 1, 2019, unless earlier purchased by the Company or converted. Interest is payable semi-annually, in arrears on April 1 and October 1 of each year, commencing October 1, 2014.

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The Notes are governed by an indenture between the Company, as issuer, and U.S. Bank National Association, as trustee. The Notes are unsecured and do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness or the issuance or repurchase of securities by the Company.

If converted, holders will receive cash and/or shares of the Company s common stock, at the Company s election. The Company s intent is to settle the principal amount of the Notes in cash upon conversion. As a result, upon conversion of the Notes, only the amounts payable in excess of the principal amount of the Notes are considered in diluted earnings per share under the treasury stock method.

| | **Conversion Rate per $1,000 Par Value** | **Initial Conversion Price per Share** | **Free Convertibility Date** |
|---|---|---|---|
| 0.125% Convertible Senior Notes | 19.1703 | $ 52.16 | October 1, 2018 |

Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events as described in the indenture governing the Notes. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than cancelled, extinguished or forfeited. Holders may convert their Notes under the following circumstances:

- during any calendar quarter commencing after June 30, 2014, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding calendar quarter, the last reported sales price of the Company s common stock for such trading day is greater than or equal to 130% of the applicable conversion price for the Notes on each applicable trading day;

- during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of the Notes is less than 98% of the product of the sale price of the Company s common stock and the conversion rate;

- upon the occurrence of specified corporate transactions described under the indenture governing the Notes, such as a consolidation, merger or binding share exchange; or

- at any time on or after October 1, 2018.

As of September 30, 2015, the Notes are not convertible.

Holders of the Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, such as a change of control, at a purchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest. Following certain corporate transactions that constitute a fundamental change, the Company will increase the conversion rate for a holder who elects to convert the Notes in connection with such make-whole fundamental change.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated conversion feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ( debt discount ) is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the term of the Notes, and transaction costs attributable to the equity component were netted with the equity component in stockholders equity. Additionally, the Company recorded a deferred tax liability of $0.8 million in connection with the Notes.

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The Notes consist of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Liability component: | | |
| Principal: | | |
| 0.125% Convertible Senior Notes | $ 402,500 | $ 402,500 |
| Less: debt discount, net | | |
| 0.125% Convertible Senior Notes | (72,595) | (86,319) |
| Net carrying amount | $ 329,905 | $ 316,181 |

The Notes are included in the consolidated balance sheets within convertible senior notes, net, which is classified as a non-current liability. The debt discount is amortized over the life of the Notes using the effective interest rate method.

The total estimated fair value of the Company s Notes at September 30, 2015 was $293.3 million. The fair value of the Notes was determined based on inputs that are observable in the market (Level 2).

Based on the closing price of the Company s common stock of $26.54 on September 30, 2015, the if-converted value of the Notes was less than their principal amount.

***Note Hedges***

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the Note Hedges ).

| | Date | Purchase (in thousands) | Shares underlying Note Hedges |
|---|---|---|---|
| Note Hedges | March 2014 | $ 85,853 | 7,716,049 |

The Note Hedges cover shares of the Company s common stock at a strike price that corresponds to the initial conversion price of the respective Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the market value per share of the Company s common stock, as measured under the Notes, at the time of exercise is greater than the conversion price of the Notes. The Note Hedges are separate transactions and are not part of the terms of the Notes. Holders of the Notes will not have any rights with respect to the Note Hedges.

***Warrants***

| | Date | Proceeds (in thousands) | Shares | Strike Price |
|---|---|---|---|---|
| Warrants | March 2014 | $ 38,278 | 7,716,049 | $ 81.14 |

Separately, in March 2014, the Company also entered into warrant transactions (the Warrants ), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, shares of the Company s common stock at $81.14 per share. The Warrants have a term of five years from the date of issuance. If the average market value per share of the Company s common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants would have a dilutive effect on the Company s earnings per share if the Company reports net income for the reporting period. The Warrants were anti-dilutive for the period ended September 30, 2015. The Warrants are separate transactions, entered into by the Company and are not part of the terms of the Notes or Note Hedges. Holders of the Notes will not have any rights with respect to the Warrants.

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***Interest Expense***

The following table sets forth total interest expense recognized related to the Notes (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| 0.125% coupon | $ 126 | $ 126 | $ 378 | $ 252 |
| Amortization of debt issuance costs | 14 | 13 | 40 | 26 |
| Amortization of debt discount | 4,641 | 4,378 | 13,724 | 8,694 |
| Total | $ 4,781 | $ 4,517 | $ 14,142 | $ 8,972 |

**6. Commitments and Contingencies**

***Leases***

The Company leases its facilities and certain office equipment under noncancellable operating leases.

The following table summarizes total rental expense (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Rental expense | $ 1,733 | $ 1,911 | $ 5,754 | $ 5,134 |

***Guarantees***

The Company offers two guarantee products to travelers: Basic Rental Guarantee and Carefree Rental Guarantee. The Basic Rental Guarantee is offered to travelers that book a vacation rental property listed on any one of the Company s websites to protect their vacation rental payments up to $1,000 against Internet fraud. Travelers can also purchase additional protection to cover their vacation rental payments up to $10,000 against Internet fraud, misrepresentation, wrongful denial of entry, wrongful deposit loss or losses from phishing claims by the purchase of the Carefree Rental Guarantee. The Company does not maintain insurance from any third party for claims under these guarantees, and any amounts payable for claims made under these guarantees are payable by the Company. Amounts recorded for estimated future claims under the guarantees are based on historical experience and expectations for future claims. Claim costs related to the Basic Rental Guarantee are recognized in general and administrative expenses in the consolidated statements of operations while claim costs related to the Carefree Rental Guarantee are recognized in cost of revenue.

Expected future claims for traveler guarantees, which are presented as a current liability in the Company s condensed consolidated balance sheets, and changes for the guarantees, are as follows (in thousands):

| | |
|---|---|
| Traveler guarantee liability at December 31, 2013 | $ 956 |
| Costs accrued for new and expected future claims | 3,576 |
| Guarantee obligations honored | (2,742) |
| Traveler guarantee liability at December 31, 2014 | $ 1,790 |
| Costs accrued for new and expected future claims | 1,216 |
| Guarantee obligations honored | (1,760) |
| Traveler guarantee liability at September 30, 2015 | $ 1,246 |

The Company maintains a guarantee of £5,000,000 (approximately $7,595,000 as of September 30, 2015) to a bank in the United Kingdom for extending credit to the Company in connection with the wholly owned United Kingdom subsidiary s business of collecting its subscription revenue in advance via credit card payments.

***Legal***

From time to time, the Company is involved in litigation relating to claims arising in the ordinary course of business. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using available information. Views on estimated losses are developed by management in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. After taking all of the above factors into account, the Company determines whether an estimated loss from a contingency related to litigation should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. The Company further determines whether an

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estimated loss from a contingency related to litigation should be disclosed by assessing whether a material loss is deemed reasonably possible. Such disclosures will include an estimate of the additional loss or range of loss or will state that such an estimate cannot be made.

Management believes that there are no claims or actions pending or threatened against the Company, the ultimate disposition of which would have a material impact on the Company s consolidated financial position, results of operations or cash flows.

**7. Stock-Based Compensation**

During the three and nine months ended September 30, 2015, the Company issued an aggregate of 502,383 and 1,686,767 restricted stock units, respectively, under its 2011 Equity Incentive Plan (the 2011 Plan ), for an aggregate fair value of $14,261,000 and $49,261,000, respectively. Additionally, during the three and nine months ended September 30, 2015, the Company issued an aggregate of 83,644 and 947,986 options, respectively, to purchase common stock under the 2011 Plan for an aggregate fair value of $958,000 and $9,995,000, respectively.

The following table summarizes the total stock-based compensation expense (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Cost of revenue | $ 881 | $ 847 | $ 2,615 | $ 2,415 |
| Product development | 3,931 | 3,485 | 10,769 | 9,589 |
| Sales and marketing | 3,152 | 2,763 | 9,003 | 7,868 |
| General and administrative | 4,654 | 5,576 | 15,100 | 15,710 |
| Total | $ 12,618 | $ 12,671 | $ 37,487 | $ 35,582 |

**8. Redeemable Noncontrolling Interests**

During the year ended December 31, 2013, the Company acquired 68.5% of the outstanding stock of Travelmob Pte. Ltd. ( travelmob ) and 55% of the outstanding stock of Bookabach Limited. During the year ended December 31, 2014, the Company acquired an additional 20% of the outstanding equity of Bookabach Limited, increasing its ownership to 75%. The redeemable noncontrolling interests are reported on the condensed consolidated balance sheets as redeemable noncontrolling interests.

The Company recognizes changes to the redemption value of noncontrolling interests as they occur by adjusting the carrying value to estimated redemption value at the end of each reporting period.

Changes in the Company s redeemable noncontrolling interests are summarized in the table below (in thousands):

| | |
|---|---|
| Balance at December 31, 2013 | $ 10,584 |
| Net loss attributable to noncontrolling interests | (1,839) |

| | |
|---|---|
| Changes to redemption value of noncontrolling interests | 2,421 |
| Repurchase of redeemable noncontrolling interests | (1,461) |
| Currency translation adjustments | 37 |
| Balance at December 31, 2014 | $ 9,742 |
| Net loss attributable to noncontrolling interests | (1,623) |
| Changes to redemption value of noncontrolling interests | 914 |
| Balance at September 30, 2015 | $ 9,033 |

In October 2015, the Company acquired the remaining outstanding equity interest of travelmob (see Note 12).

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## 9. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Foreign currency translation adjustments | $ (56,276) | $ (27,252) |
| Unrealized losses on short-term investments | (183) | (801) |
| Defined benefit pension plan adjustments | (4,149) | |
| Total | $ (60,608) | $ (28,053) |

## 10. Income Taxes

The following table summarizes the total income tax expense that the Company recorded, and the related effective tax rate, for the three and nine months ended September 30, 2015 and 2014 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Income tax expense | $ 5,625 | $ 845 | $ 9,757 | $ 5,909 |
| Effective tax rate | 36.3% | 13.9% | 65.1% | 31.5% |

At September 30, 2015, the Company s effective tax rate estimate for the year ending December 31, 2015 differed from the statutory rate primarily due to losses in certain foreign jurisdictions for which a benefit cannot be recorded at this time, non-deductible stock compensation charges and state taxes, which is offset by the effect of different statutory tax rates in foreign jurisdictions and certain items recorded discretely in the nine months ended September 30, 2015. Those discrete items include a tax benefit due to disqualifying dispositions of incentive stock options, a tax benefit due to an income tax reserve release, a tax benefit for adjustments to the recognized value of the Company s federal and Texas research and experimentation tax credit carryforwards and a tax benefit of $0.4 million related to a correction of an immaterial prior period transfer pricing error, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. The effective tax rate for the three months ended September 30, 2015 is lower than the effective tax rate estimated for the full year ending December 31, 2015 due to higher income before income taxes in the three months as well as the mix of earnings between income and loss jurisdictions.

On July 27, 2015, in Altera Corp. v. Commissioner, the U.S. Tax Court issued a taxpayer-favorable opinion related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. A final decision has yet to be issued by the Tax Court due to other outstanding issues related to the case, and the decision is subject to appeal by the Internal Revenue Service. At this time, the U.S. Department of the Treasury has not withdrawn the requirement to include stock-based compensation from its regulations. The Company has reviewed this case and its impact and has concluded that no adjustment to the consolidated financial statements is appropriate at this time. The Company will continue to monitor ongoing developments and potential impacts to the condensed consolidated financial statements.

At September 30, 2014, the Company s effective tax rate estimate differed from the statutory rate primarily due to non-deductible stock compensation charges and state taxes, which was partially offset by the effect of different statutory tax rates in foreign jurisdictions and certain items recorded discretely in the nine months ended September 30, 2014. Those discrete items include a tax benefit due to disqualifying dispositions of incentive stock options, a tax benefit for a state tax apportionment change related to a prior period, a tax benefit for adjustments to the recognized value of our federal and Texas research and experimentation tax credit carryforwards, and a tax benefit resulting from the filing of certain 2013 tax returns, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. In addition, the merger of our wholly owned subsidiaries in Spain in the three months ended September 30, 2014 resulted in tax basis intangibles which will be deductible in future periods, with a tax benefit of $2.5 million recorded discretely.

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### 11. Net Income Per Share Attributable to HomeAway, Inc.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| **Numerator** | | | | |
| Net income attributable to HomeAway, Inc. | $ 10,417 | $ 4,912 | $ 5,942 | $ 13,222 |
| **Denominator** | | | | |
| Weighted average common shares outstanding - basic | 95,716 | 94,106 | 95,162 | 93,507 |
| Dilutive effect of stock options, warrants and restricted stock units | 1,972 | 2,283 | 2,227 | 2,851 |
| Weighted average common shares outstanding - diluted | 97,688 | 96,389 | 97,389 | 96,358 |
| Net income per share attributable to HomeAway, Inc.: | | | | |
| Basic | $ 0.11 | $ 0.05 | $ 0.06 | $ 0.14 |
| Diluted | $ 0.11 | $ 0.05 | $ 0.06 | $ 0.14 |

The following common equivalent shares were excluded from the calculation of diluted net loss per share attributable to HomeAway, Inc. as their inclusion would have been anti-dilutive (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Stock options | 3,295 | 2,604 | 3,089 | 2,038 |
| Restricted stock units | 547 | 62 | 21 | 49 |
| Warrants | 7,716 | 7,716 | 7,716 | 7,716 |
| Total common equivalent shares excluded | 11,558 | 10,382 | 10,826 | 9,803 |

### 12. Subsequent Events

(i) On October 1, 2015, the Company acquired Dwellable, Inc., a United States company that is the creator of an online vacation rental search engine and mobile application that provides unique, interactive ways for travelers to find and book vacation rentals, for cash consideration of $18.0

million.

(ii) In the fourth quarter of 2013, the Company acquired a controlling interest in travelmob. Under the terms of the acquisition agreement, the Company had a call option to purchase the remaining non-controlling interest of travelmob for the period defined in the agreement beginning on December 31, 2016. In the event the Company did not exercise its call option to purchase the remaining shares of travelmob by such deadline, the remaining travelmob stockholders had a put option to require the Company to repurchase their remaining interest for the period defined in the agreement beginning on February 1, 2017. The call and put were accounted for as embedded features of the non-controlling interest.

In October 2015, the Company and the non-controlling interest holders agreed to terminate the call and put options and the Company acquired the remaining outstanding equity interest of travelmob. In connection with the mutual termination of the options, in the fourth quarter of 2015, the Company will recognize an operating expense charge of approximately $3.9 million representing the amount paid for the acquisition of the non-controlling interest in excess of the fair value of the non-controlling interest prior to the termination of the options.

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(iii) On November 4, 2015, the Company, Expedia, Inc., a Delaware corporation ( Expedia ), and HMS 1, Inc., a Delaware corporation and a direct wholly owned subsidiary of Expedia ( Purchaser )entered into an Agreement and Plan of Reorganization (the Merger Agreement ). Pursuant to the Merger Agreement, Purchaser commenced a tender offer to acquire all of the outstanding shares of Company common stock for an equity value of approximately $3.9 billion in cash and Expedia common stock, representing a per share price for HomeAway shares of $38.31, based on Expedia s closing price on November 3, 2015. Under the terms of the transaction, Expedia will offer to acquire each outstanding share of common stock of HomeAway in exchange for $10.15 in cash and 0.2065 of a share of Expedia common stock. Under the terms of the transaction, Expedia will acquire each outstanding share of common stock of HomeAway through a tender offer, followed by a second-step merger.

The Board of Directors of the Company unanimously approved the Merger Agreement and the consummation of the transactions contemplated thereby, including the tender offer and the Mergers. Consummation of the transactions is subject to the satisfaction or, if permissible, waiver of customary closing conditions, including there having been validly tendered and not validly withdrawn prior to the expiration of the tender offer a majority of all then outstanding shares of Company common stock, the absence of certain legal impediments and the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

The Merger Agreement contains certain termination rights, including the right of the Company to terminate the Merger Agreement to accept a superior proposal (subject to compliance with certain notice and other requirements). The Merger Agreement provides that, in connection with termination of the Merger Agreement by the Company or Expedia upon specified conditions, the Company will be required to pay to Expedia a termination fee of $138 million. In addition, subject to certain exceptions and limitations, the Company or Expedia may terminate the Merger Agreement if the Merger is not consummated by May 4, 2016 (or as such date may be extended pursuant to the terms of the Merger Agreement).

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

### Safe Harbor Cautionary Statement

*This quarterly report on Form 10-Q contains forward-looking statements that are based on our management s beliefs and assumptions and on information currently available to our management. The statements contained in this quarterly report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may be signified by terms such as anticipates, believes, could, seeks, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would or similar expressions and the negatives of those terms. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in other documents we file with the Securities and Exchange Commission. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management s beliefs and assumptions only as of the date of this quarterly report on Form 10-Q. You should read this quarterly report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.*

*The following discussion should be read in conjunction with our interim condensed consolidated financial statements contained elsewhere in this quarterly report on Form 10-Q and in our other Securities and Exchange Commission, or SEC, filings including our Annual Report on Form 10-K for the year ended December 31, 2014 and subsequent reports on Form 8-K, which discuss our business in greater detail.*

### Overview

HomeAway, Inc. and its wholly and majority-owned subsidiaries ( HomeAway , the Company , we , us and our ) o the world s largest online marketplace for the vacation rental industry, bringing together millions of travelers seeking vacation rentals online with the property owners and managers of over one million vacation rental properties located in over 190 countries around the world. Our portfolio includes leading global vacation rental websites. During the three and nine months ended September 30, 2015, our websites attracted approximately 272 million and 834 million website visits, respectively, and as of September 30, 2015, our global marketplace included approximately 1.2 million paid listings. We continue to focus on providing the largest selection of properties to travelers and the most qualified inquiries and bookings to property owners and managers.

*The majority of our revenue is generated from our paid listing business.* Our subscription listings generate the majority of our paid listing revenues and generally have annual terms. We continued to improve monetization of our subscription listing base in the three and nine months ended September 30, 2015 through pricing and product changes including continued adoption of our tiered pricing structure and sales of bundled listings. This improved monetization can be seen in the increase in our average revenue per subscription listing measured on a constant currency basis for the three and nine months ended September 30, 2015. Tiered pricing allows property owners and managers with paid subscriptions to improve their position in search results by purchasing a higher subscription level, or tier. Bundled listings provide subscribers the opportunity to purchase additional distribution on multiple HomeAway websites. We also offer performance-based pricing on most websites, which allows property owners and managers to list their properties for free and pay a commission for bookings. In order to grow our revenue from performance-based listings, we will continue to focus on increasing the number of bookings for these customers. Additionally, we believe that we can grow the number of performance-based paid listings and generate additional bookings and revenue.

*We believe a large selection of qualified properties is necessary to attract and retain travelers.* Our total paid listings grew from September 30, 2014 to September 30, 2015 by 15.5% as we added approximately 160,000 new paid listings, net of non-renewals. Subscription listings declined slightly compared to last year as new subscriptions were offset with non-renewals. However performance-based listings grew by 50.5% to approximately 480,000 listings as property owners and managers continued to adopt the new performance-based model. We expect performance-based listings will continue to grow at a faster rate than subscriptions. Additionally, we are continually investing in product enhancements and property owner and manager communications to encourage high quality listings on our websites to ensure a positive experience for travelers.

*Enablement of online booking capabilities on our websites has been and will continue to be a focus for our Company.* While the inquiry process still remains important to many travelers in the selection of a vacation rental, we believe online bookable properties will provide a better experience for travelers and offers greater process efficiencies for many of our property owners and managers. We continue to see increased adoption of paid listings that are online bookable as well as increased adoption of our online payments platform, which is currently available on the majority of our websites.

We consider a listing to be online bookable when it has a fully updated calendar and rates, which allows the traveler to accurately estimate the cost of the stay. In some cases the booking will take place immediately and in other cases our property owners and managers will require additional information before accepting or rejecting the booking request. As to payment processing, property owners and managers are encouraged but not required to use our payments platform which is continuously being improved to support multiple payment methods. This is important for our global marketplace. We also allow payments to be processed offline or through integrated platforms. Property owners and managers, in some countries, can make value-added products available for purchase through our payments platform. We believe adoption and increased use of our platform over time will allow us to earn more revenue from ancillary products and fees while providing a more secure and efficient payment mechanism for travelers. We plan to introduce new products and services for travelers, property owners and managers which we believe will provide further opportunities to generate revenue through our marketplace.

*We believe bringing travelers to our online marketplace is necessary to attract and retain vacation rental owners and managers as well as increase revenue from commissions and value-added-services.* It is also critical for us to increase the rate at which travelers book vacation rentals with our property owners and managers. To meet these challenges, which are even more important with the increase in performance-based listings, we are focused on a combination of marketing strategies including pay-per-click advertising, search engine optimization and brand and display advertising, with a goal of driving more travelers and bookings to our websites as well as increasing the exposure of the vacation rental category. We expect spending in sales and marketing to increase over time as we add online and offline marketing campaigns to increase our brand awareness to travelers and property owners and managers, and as we increase our marketing support for our growing performance-based listing base. During the nine months ended September 30, 2015, we increased our sales and marketing expenses by $26.6 million compared to the nine months ended September 30, 2014. We are continuously investing in product enhancements to make it easier for travelers visiting our websites to search and find the right property, to inquire and to book their stay.

*We believe conversion of traveler visits to bookings is necessary for long term growth of our business.* The combination of increasing visits to our websites and conversion of those visits to bookings allows us to deliver value to property owners and managers which supports renewal of listings, increases our opportunity for revenue on transactions booked through our platform, and increases the commission revenue we earn from performance based listings.

*Our financial reporting currency is the U.S. dollar and changes in foreign exchange rates significantly affect our reported results and consolidated trends.* For example, if the U.S. dollar strengthens year-over-year relative to currencies in our international locations, our consolidated revenues and operating expenses will be lower than if currencies had remained constant. Likewise, if the U.S. dollar weakens year-over-year relative to currencies in our international locations, our consolidated revenues and operating expenses will be higher than if currencies had remained constant. We believe our diversification beyond the U.S. economy through our international businesses benefits our stockholders over the long term. We also believe it is useful to evaluate key operating results and growth rates before and after the effect of currency changes. Additionally, the re-measurement of our intercompany balances can result in significant gains and charges associated with the effect of movements in foreign currency exchange rates. Currency volatilities may continue, which could significantly impact (either positively or negatively) our reported results and consolidated trends and comparisons.

**Acquisitions**

Since our inception and through September 30, 2015, we have acquired 22 businesses as part of our growth strategy. Our acquisitions have presented, and certain of them continue to present, significant integration challenges. They have required us to integrate new operations, offices and employees and to formulate and execute on marketing, product and technology strategies associated with the acquired businesses. In some cases, we continue to manage multiple brands and technology platforms of the acquired businesses, which has increased our cost of operations. Challenges of this nature are likely to arise if we acquire businesses in the future.

**Growth Opportunities and Trends**

We believe that our ability to further grow our revenue will depend largely on increasing the number of paid listings, increasing revenue per listing and increasing revenue from other products, services and fees through our marketplace. Our achievement of these objectives will further depend on our ability to successfully enable more online bookable listings and to drive more bookings to our paid listings. Achieving growth in the number of paid listings involves our ability to increase our paid listing renewal rates, reach new property owners and managers through marketing or telesales activities or obtain new paid listings through geographic expansion, strategic acquisitions or investments. We believe that increasing revenue per listing and revenue from other products and services will involve our ability to successfully drive more transactions through our platform as well as increased adoption of our products and services, such as higher adoption of our payments platform. Furthermore, we believe our ability to successfully modify or introduce new products, services and fees will be important in achieving future revenue growth.

In the future, we believe it will become more important to increase marketing investments to grow and further advertise our brand and products to travelers. We have seen other companies launch online businesses offering vacation rentals or other alternatives to hotels. We believe this growing favorable awareness of alternatives to hotels has and will continue to support growth in our business. However, we have also seen a trend of increased government regulation and taxation of the industry. We continue to monitor the effects of these trends and intend to take actions as necessary to mitigate their effects.

**Key Financial Highlights**

Since our commercial launch in 2005, our revenue growth has been attributable to our acquisitions of other online listings businesses, organic growth in the number of listings purchased by property owners and managers, increases in the average revenue per listing due to additional features and price increases, and the introduction of additional products and services related to our marketplace. We view our market opportunity as global and have historically generated strong cash flows. Additionally, we have experienced predictable financial results because of our advance payment, subscription-based model and our high annual listing renewal rates. However, our revenue predictability may be affected as we develop new and alternative sources of revenue.

Key financial highlights for the three months ended September 30, 2015 include the following:

- Total revenue was $130.7 million compared to $117.1 million in the third quarter of 2014, or an increase of 11.6%; measured on a constant currency basis, total revenue increased by 19.8%;

- Percentage of total revenue from outside the United States was 34.4% in the third quarter, compared to 40.6% in the third quarter of 2014; total revenue from outside the United States in the third quarter of 2015 included 29.3% from Europe and 5.1% from South America and the Asia Pacific region;

- Listing revenue was $106.5 million compared to $96.6 million in the third quarter of 2014 and contributed 81.5% of total revenue compared to 82.5% in the third quarter of 2014;

- Net income attributable to HomeAway, Inc. was $10.4 million, or $0.11 per diluted share, compared to net income of $4.9 million, or $0.05 per diluted share, in the third quarter of 2014;

- Cash from operating activities was $24.6 million compared to $25.5 million in the third quarter of 2014, or a decrease of 3.5%;

- Adjusted EBITDA was $40.2 million compared to $31.6 million in the third quarter of 2014, or an increase of 27.2%; Adjusted EBITDA as a percentage of revenue was 30.8%, an increase from 27.0% in the third quarter of 2014;

Free cash flow was $24.9 million compared to $20.0 million in the third quarter of 2014, or an increase of 24.5%; on a trailing twelve month basis, free cash flow increased 8.6% to $127.2 million from $117.2 million in the comparable trailing twelve month period for the prior year;

Non-GAAP net income was $23.5 million, or $0.24 per diluted share, compared to non-GAAP net income of $18.9 million, or $0.20 per diluted share, in the third quarter of 2014; and

Cash, cash equivalents and short-term investments as of September 30, 2015 were $919.6 million.

For further discussion regarding Adjusted EBITDA, free cash flow and non-GAAP net income, along with reconciliations of such numbers to the most directly comparable financial measures calculated and presented in accordance with GAAP, please see the information under the caption Discussion of Non-GAAP Financial Measures in Item 2 of this Quarterly Report on Form 10-Q.

**Key Business Metrics**

In addition to traditional financial and operational metrics, we use the following business metrics to monitor and evaluate results:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Paid listings (in thousands): | | | | |
| Subscription listings, end of period | 715 | 716 | 715 | 716 |
| Performance listings, end of period | 480 | 319 | 480 | 319 |
| Total paid listings, end of period | 1,195 | 1,035 | 1,195 | 1,035 |
| Paid listings, growth year-over-year | 15.5% | 33.8% | 15.5% | 33.8% |
| Average revenue per subscription listing | $ 514 | $ 479 | $ 501 | $ 476 |
| Average revenue per subscription listing, growth year-over-year | 7.3% | 11.9% | 5.3% | 12.8% |
| Subscription renewal rate, end of period | 72.4% | 72.2% | 72.4% | 72.2% |
| Visits to websites (in millions) | 272 | 232 | 834 | 707 |
| Visits to websites, growth year-over-year | 17.3% | 17.3% | 18.0% | 16.6% |

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*Paid Listings.* The majority of our revenue is derived from paid listings which we regularly track as a key revenue growth indicator and to identify trends in our business and industry. The growth in paid listings is due to our marketing and selling new and additional listings to property owners and managers, the addition of performance-based listings, organic growth from property owners and managers who become aware of our websites and choose to market their properties, and new listings added through new affiliates or acquisitions. For the period, we added a significant number of performance-based listings.

When we migrate one of our websites to our global technology platform, property owners and managers that have listings on the pre-migrated website and on a website already on our global technology platform are able to consolidate their listings into one listing displayed on both websites. Additionally, platform consolidations allow property owners and managers to purchase bundled listings that include display on multiple websites that exist on the global technology platform. As a result of a website migration, we count each of these bundled listings as one listing. This impacts the comparability of our current period reported metrics to our previously reported metrics for paid listings, renewal rate and average revenue per listing. We migrated the VRBO.com website to our global technology platform in 2012 and in the second quarter of 2014, we migrated Homelidays.com to our global technology platform. In the second quarter of 2015, we migrated the Owners Direct Holiday Rentals.co.uk website to our global technology platform. Furthermore, we expect future platform migrations for certain of our websites, such as Stayz.com.au, to our global technology platform. When this occurs, property owners and managers who have purchased subscriptions on the website being migrated as well as other HomeAway websites will be given the opportunity to consolidate their listings through the purchase of a bundled listing. We expect these migrations to impact the comparability of future operating metrics.

As a result of consolidated and bundled listings, our paid listing counts will be lower because these listings previously would have been counted as multiple paid listings had they been purchased on multiple websites. The lower paid listing counts from consolidations and bundles will in turn lower our reported subscription renewal rate. However, our bundled listing products generally have a higher overall price and we expect they will increase our average revenue per subscription listing. We intend to disclose and discuss the trends of the business resulting from these consolidated listings when there is a significant impact.

As the number of paid listings increases, we believe we will generate additional revenue while also expanding the value of the marketplace to travelers, thus increasing the likelihood travelers will find a property suitable to their needs. It is possible a specific property may be listed on more than one of our websites without indicating that the multiple listings refer to the same property.

*Average Revenue per Subscription Listing.* We compute average revenue per subscription listing as annualized subscription listing revenue divided by the average of paid subscription listings at the beginning and end of the period. We believe trends in revenue per subscription listing, over an extended period, are important to understanding the value we bring to property owners and managers, and the overall health of our marketplace. As the majority of our listing business is generated from subscriptions, we use trends in revenue per subscription listing, as well as trends in paid listings, to formulate financial projections and make strategic business decisions. At a consolidated level, increases in revenue per subscription listing may increase our earnings or may be used for future investment. The average revenue per subscription listing may fluctuate based on the timing and nature of acquisitions, changes in our pricing, the impact of consolidated and bundled listing products, uptake and pricing of listing enhancements, seasonality, changes in brand and listing type mix, and the impact of foreign exchange rates on our listing revenue outside of the United States.

In order to provide a comparable framework for assessing average revenue per subscription listing, excluding the effect of foreign currency fluctuations, we analyze year-over-year growth on a constant currency basis by calculating average revenue per subscription listing in the current period using exchange rates from the comparable prior period. Excluding the impact of foreign exchange rates, average revenue per subscription listing would have been $554 and $544 in the three and nine months ended September 30, 2015, respectively, an increase of 15.7% and 14.3%, respectively, when compared to $479 and $476 as reported in the three and nine months ended September 30, 2014, respectively.

In order to increase revenue per subscription listing, we rely on increases in base pricing, adoption of tiered pricing and bundled listings for our property owners and managers. We began offering tiered pricing on HomeAway.com in the United States in 2011 and have continued to launch tiered pricing to our sites globally, bringing the total number of our websites that provide tiered pricing alternatives to 19. As we continue to implement tiered pricing on other websites, or change the prices or structure of tiered pricing, we may see an impact on listing sales in the period of the change and revenue thereafter.

*Subscription Renewal Rate.* The renewal rate for our subscription listings at the end of any period is defined as the percentage of those paid listings active at the end of the period ended twelve months prior that are still active as of the end of the current reported period. Unique property subscription listings removed from property managers accounts and subsequently replaced with new subscription listings within the same property manager s account listings are not considered as renewals in our renewal rate calculation. We include most subscription listings in our calculation of renewal rate, with the exception of subscriptions sold by BedandBreakfast.com, Bookabach.co.nz and Stayz.com.au, which will remain excluded until we can further develop our systems. However, based on our review of other internal renewal rate data, we do not believe the exclusion of these brands from the renewal rate calculation materially impacts the result. We exclude pay-for-performance listings from our renewal rate analysis because they are not sold on a subscription basis.

Renewal of paid subscription listings is a key driver of revenue for our business. We track renewal rate in order to understand and improve property owners and managers satisfaction and to help us more accurately estimate our future revenue and cash flows. Our overall renewal rate for the nine months ended September 30, 2015 stayed relatively constant compared to the nine months ended September 30, 2014. Beginning in the second quarter of 2015, customers in Australia were directed to Stayz.com.au to list their property and were not able to renew their listing on HomeAway Australia. Accordingly, beginning in the second quarter of 2015, we exclude HomeAway Australia from the subscription renewal rate calculation. All periods prior to the second quarter of 2015 have been revised to exclude HomeAway Australia. We continue to make product improvements and increase our investment in demand generation for property owners and managers in order to increase customer satisfaction and improve renewal rates. In addition, several other factors affect renewal rates including our property owners and managers ability to consolidate their listings, their ability to purchase geographic bundled listings and our use of promotional pricing to attract new subscribers. Our paid subscription listing renewal rate could also be impacted by property owners and managers who elect to list their properties through our pay-per-booking commission offering, rather than paying a subscription fee. With increase adoption of our pay-per-booking listing product, we anticipate evaluating measuring a total customer retention rate in the future to complement our subscription renewal rate measure to provide a more complete picture of our marketplace supply.

*Visits to Websites.* We view visits to websites as a key indicator of growth in our brand awareness among users and our ability to provide our property owners and managers with inquiries and bookings from travelers. We believe that growth in visits to websites will be driven by our marketing strategies and has both a direct and indirect impact on our financial performance. We use a variety of tools to measure visits to our websites, including solutions from third parties such as Google Analytics. We also review third-party published reports to measure our results against comparable companies; however, these reports are frequently inconsistent with our internal measurements.

We believe certain quality initiatives aimed at reducing the number of visits required to secure a booking may have a negative impact on growth in visits while providing a positive experience for travelers and property owners and managers. These initiatives include online booking, quotable rates, and continuous improvements to our search functionality to help travelers locate appropriate properties more quickly.

## Critical Accounting Policies and Estimates

Our condensed consolidated financial statements include the accounts of our U.S.-based operations and our partially and wholly-owned subsidiaries throughout the world and are prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. To the extent there are material differences between these estimates and our actual results, our condensed consolidated financial statements will be affected.

Our significant accounting policies are described in Note 2 to the accompanying condensed consolidated financial statements. The methods, estimates and judgments we use in applying our accounting policies have a significant impact on our results of operations. Accordingly, we believe the policies listed below involve the greatest degree of complexity and judgment by our management and are the most critical for understanding and evaluating our financial condition and results of operations. These critical accounting policies are:

- Revenue recognition;

- Business combinations;

- Convertible senior notes and the related warrants and hedges;

- Stock-based compensation; and

- Income taxes.

A description of our critical accounting policies that involve significant management judgments appears in our Annual Report on Form 10-K for the year ended December 31, 2014 under Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

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**Results of Operations**

The following table presents our operating results and our operating results as a percentage of revenue for the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| | (in thousands, except per share data) | | | |
| **Condensed Consolidated Statements of Operations Data:** | | | | |
| Revenue: | | | | |
| Listing | $ 106,484 | $ 96,601 | $ 301,281 | $ 278,459 |
| Other | 24,198 | 20,511 | 74,272 | 58,591 |
| Total revenue | 130,682 | 117,112 | 375,553 | 337,050 |
| Costs and expenses: | | | | |
| Cost of revenue (exclusive of amortization shown separately below) | 19,361 | 16,926 | 58,472 | 50,291 |
| Product development | 22,058 | 20,212 | 65,235 | 56,952 |
| Sales and marketing | 42,963 | 42,234 | 143,850 | 117,251 |
| General and administrative | 23,874 | 22,995 | 72,115 | 69,467 |
| Amortization expense | 2,819 | 3,397 | 8,713 | 10,163 |
| Total costs and expenses | 111,075 | 105,764 | 348,385 | 304,124 |
| Operating income | 19,607 | 11,348 | 27,168 | 32,926 |
| Other income (expense): | | | | |
| Interest expense | (4,718) | (4,373) | (13,971) | (8,842) |
| Interest income | 927 | 552 | 2,426 | 1,117 |
| Other expense, net | (338) | (1,434) | (633) | (6,452) |
| Total other income (expense) | (4,129) | (5,255) | (12,178) | (14,177) |
| Income before income taxes | 15,478 | 6,093 | 14,990 | 18,749 |
| Income tax expense | (5,625) | (845) | (9,757) | (5,909) |
| Net income | 9,853 | 5,248 | 5,233 | 12,840 |
| Less: Impact of noncontrolling interests, net of tax | (564) | 336 | (709) | (382) |
| Net income attributable to HomeAway, Inc. | $ 10,417 | $ 4,912 | $ 5,942 | $ 13,222 |
| Net income per share attributable to HomeAway Inc.: | | | | |
| Basic | $ 0.11 | $ 0.05 | $ 0.06 | $ 0.14 |

| | | | | |
|---|---|---|---|---|
| Diluted | $ 0.11 | $ 0.05 | $ 0.06 | $ 0.14 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 95,716 | 94,106 | 95,162 | 93,507 |
| Diluted | 97,688 | 96,389 | 97,389 | 96,358 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| **Condensed Consolidated Statements of Operations as a Percentage of Revenue:** | | | | |
| Revenue: | | | | |
| Listing | 81.5% | 82.5% | 80.2% | 82.6% |
| Other | 18.5 | 17.5 | 19.8 | 17.4 |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 |
| Costs and expenses: | | | | |
| Cost of revenue (exclusive of amortization shown separately below) | 14.8 | 14.5 | 15.6 | 14.9 |
| Product development | 16.9 | 17.3 | 17.4 | 16.9 |
| Sales and marketing | 32.9 | 36.1 | 38.3 | 34.8 |
| General and administrative | 18.3 | 19.6 | 19.2 | 20.6 |
| Amortization expense | 2.2 | 2.9 | 2.3 | 3.0 |
| Total costs and expenses | 85.0 | 90.3 | 92.8 | 90.2 |
| Operating income | 15.0 | 9.7 | 7.2 | 9.8 |
| Other income (expense): | | | | |
| Interest expense | (3.6) | (3.7) | (3.7) | (2.6) |
| Interest income | 0.7 | 0.5 | 0.6 | 0.3 |
| Other expense, net | (0.3) | (1.2) | (0.2) | (1.9) |
| Total other income (expense) | (3.2) | (4.5) | (3.2) | (4.2) |
| Income before income taxes | 11.8 | 5.2 | 4.0 | 5.6 |
| Income tax expense | (4.3) | (0.7) | (2.6) | (1.8) |
| Net income | 7.5 | 4.5 | 1.4 | 3.8 |
| Less: Impact of noncontrolling interests, net of tax | (0.4) | 0.3 | (0.2) | (0.1) |
| Net income attributable to HomeAway, Inc. | 8.0% | 4.2% | 1.6% | 3.9% |

**Comparison of the Three and Nine Months Ended September 30, 2015 and 2014**

***Revenue***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| **Revenue** | **Amount** | **Percentage of Revenue** | **Amount** | **Percentage of Revenue** | **Amount** | **Percent** |
| | (dollars in thousands) | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Listing | $ 106,484 | 81.5% | $ 96,601 | 82.5% | $ 9,883 | 10.2% |
| Other | 24,198 | 18.5 | 20,511 | 17.5 | 3,687 | 18.0 |
| Total | $ 130,682 | 100.0% | $ 117,112 | 100.0% | $ 13,570 | 11.6% |

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| **Revenue** | **Amount** | **Percentage of Revenue** | **Amount** | **Percentage of Revenue** | **Amount** | **Percent** |
| | | | (dollars in thousands) | | | |
| United States | $ 85,759 | 65.6% | $ 69,564 | 59.4% | $ 16,195 | 23.3% |
| International | 44,923 | 34.4 | 47,548 | 40.6 | (2,625) | (5.5) |
| Total | $ 130,682 | 100.0% | $ 117,112 | 100.0% | $ 13,570 | 11.6% |

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| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| Revenue | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Listing | $ 301,281 | 80.2% | $ 278,459 | 82.6% | $ 22,822 | 8.2% |
| Other | 74,272 | 19.8 | 58,591 | 17.4 | 15,681 | 26.8 |
| Total | $ 375,553 | 100.0% | $ 337,050 | 100.0% | $ 38,503 | 11.4% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| Revenue | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| United States | $ 244,410 | 65.1% | $ 195,786 | 58.1% | $ 48,624 | 24.8% |
| International | 131,143 | 34.9 | 141,264 | 41.9 | (10,121) | (7.2) |
| Total | $ 375,553 | 100.0% | $ 337,050 | 100.0% | $ 38,503 | 11.4% |

*For the Three Months Ended September 30, 2015*

Our overall revenue growth rate for the three months ended September 30, 2015 was 11.6%. All of our revenue growth in the period was organic revenue growth. We consider growth to be organic if generated from businesses we have owned for at least 12 months.

*Listing Revenue*

Our core listing business revenue increased primarily due to increases in new paid listings, increases in average revenue per subscription listing and higher performance-based commissions. Paid listings increased from 1.0 million at September 30, 2014 to 1.2 million at September 30, 2015 primarily due to selling new and additional performance-based listings to property owners and managers. For our subscription listings, our average revenue per subscription listing was $514 in the three months ended September 30, 2015 compared to $479 in the three months ended September 30, 2014, an increase of $35, or 7.3%. We continued to improve monetization of our subscription listing base through continued adoption of our tiered pricing structure and an increase in bundled listings products.

*Other Revenue*

Other revenue increased by $3.7 million, or 18.0%, in the three months ended September 30, 2015 compared to the three months ended September 30, 2014. Revenue from products focused on travelers and property owners, such as insurance products, the Carefree Rental Guarantee and software products increased by $3.7 million in the three months ended September 30, 2015 compared to the same period in 2014. Furthermore, a $1.4 million increase in revenue from merchant bank credit card royalties was offset by a $1.4 million decrease in advertising and other revenues in the three months ended September 30, 2015 compared to the same period in 2014.

*Revenue Growth in Constant Currency*

We invoice and collect payments in the Euro, British Pound, Brazilian Real, Australian Dollar, Singapore Dollar and New Zealand Dollar, as well as other currencies. As a result, our total revenue is affected by changes in the value of the U.S. dollar relative to these other currencies. In order to provide a comparable framework for assessing our business performance, excluding the effect of foreign currency fluctuations, we analyze year-over-year revenue growth on a constant currency basis by calculating revenue in the current period using exchange rates from the comparable prior period. In the three months ended September 30, 2015, the year-over-year growth in listing revenue measured on a constant currency basis was 19.7%, compared with 10.2% as reported. The year-over-year growth in total revenue in the three months ended September 30, 2015 measured on a constant currency basis was 19.8%, compared with 11.6% as reported.

*For the Nine Months Ended September 30, 2015*

Our overall revenue growth rate for the nine months ended September 30, 2015 was 11.4%. We consider growth to be organic if generated from businesses that we have owned for at least 12 months.

*Listing Revenue*

Our core listing business revenue increased primarily due to increases in new paid listings, increases in average revenue per subscription listing and higher performance-based commissions. Paid listings increased from 1.0 million at September 30, 2014 to 1.2 million at September 30, 2015 primarily due to selling new and additional performance-based listings to property owners and managers. Our average revenue per subscription listing was $501 in the nine months ended September 30, 2015 compared to $476 in the nine months ended September 30, 2014, an increase of $25, or 5.3%. We continued to improve monetization of our subscription listing base through continued adoption of our tiered pricing structure and an increase in bundled listings products.

*Other Revenue*

Other revenue increased by $15.7 million, or 26.8%, in the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. Revenue from products focused on travelers and property owners, such as insurance products, the Carefree Rental Guarantee and software products increased by $13.0 million in the nine months ended September 30, 2015 compared to the same period in 2014. Furthermore, a $4.1 million increase in revenue from merchant bank credit card royalties was partially offset by a $1.4 million decrease in advertising and other revenues in the nine months ended September 30, 2015 compared to the same period in 2014.

*Revenue Growth in Constant Currency*

We invoice and collect payments in the Euro, British Pound, Brazilian Real, Australian Dollar, Singapore Dollar and New Zealand Dollar, as well as other currencies. As a result, our total revenue is affected by changes in the value of the U.S. dollar relative to these other currencies. In order to provide a comparable framework for assessing our business performance, excluding the effect of foreign currency fluctuations, we analyze year-over-year revenue growth on a constant currency basis by calculating revenue in the current period using exchange rates from the comparable prior period. In the nine months ended September 30, 2015, the year-over-year growth in listing revenue measured on a constant currency basis was 17.9%, compared with 8.2% as reported. The year-over-year growth in total revenue in the nine months ended September 30, 2015 measured on a constant currency basis was 19.8%, compared with 11.4% as reported.

***Cost of Revenue***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Cost of revenue | $ 19,361 | 14.8% | $ 16,926 | 14.5% | $ 2,435 | 14.4% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Cost of revenue | $ 58,472 | 15.6% | $ 50,291 | 14.9% | $ 8,181 | 16.3% |

*For the Three Months Ended September 30, 2015*

Compensation costs for our customer service and web-hosting personnel, including non-cash stock-based compensation, increased by $0.9 million due to 65 new customer support and web-hosting personnel as of September 30, 2015 compared to September 30, 2014. With the increased headcount and higher investments in hosting equipment, we incurred a higher expense for facilities and depreciation, which increased by $0.3 million, or 12.4%. Other increases include $1.0 million of software licenses and maintenance costs for our corporate systems and $0.2 million in equipment expenses, web hosting fees and merchant fees.

*For the Nine Months Ended September 30, 2015*

Compensation costs for our customer service and web-hosting personnel, including non-cash stock-based compensation, increased by $3.5 million due to an increase in new customer support and web-hosting personnel during the nine months ended September 30, 2015. With the increased headcount and higher investments in hosting equipment, we incurred a higher expense for facilities and depreciation, which increased by $1.6 million, or 23.5%. Other increases included $0.4 million in increases in equipment expenses, web hosting fees and merchant fees and $2.6 million in software licenses and maintenance for our corporate systems.

For the full year 2015, we expect to continue to increase expenses across the organization to support our growth and expect cost of revenue to grow in absolute dollars and stay relatively consistent as a percentage of revenue.

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***Product Development***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Product development | $ 22,058 | 16.9% | $ 20,212 | 17.3% | $ 1,846 | 9.1% |
| Capitalized software development costs | 2,536 | 1.9 | 1,912 | 1.6 | 624 | 32.6 |
| Total product and technology costs expensed and capitalized | $ 24,594 | 18.8% | $ 22,124 | 18.9% | $ 2,470 | 11.2% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Product development | $ 65,235 | 17.4% | $ 56,952 | 16.9% | $ 8,283 | 14.5% |
| Capitalized software development costs | 6,859 | 1.8 | 6,384 | 1.9 | 475 | 7.4 |
| Total product and technology costs expensed and capitalized | $ 72,094 | 19.2% | $ 63,336 | 18.8% | $ 8,758 | 13.8% |

*For the Three Months Ended September 30, 2015*

Compensation costs for product and development personnel, including non-cash stock-based compensation, increased by $2.3 million due to 41 new employees in product development as of September 30, 2015 compared to September 30, 2014. Overall increases in headcount also drove higher facilities and depreciation expense of $0.2 million. Including capitalized software development costs, total product and development expenses stayed relatively constant as a percentage of revenue at 18.8% in the three months ended September 30, 2015 as compared to 18.9% in the three months ended September 30, 2014.

*For the Nine Months Ended September 30, 2015*

Compensation costs for product and development personnel, including non-cash stock-based compensation, increased by $7.5 million due to an increase in new employees in product development during the nine months ended September 30, 2015. Overall increases in headcount also drove higher facilities and depreciation expense of $1.0 million and $0.2 million in subscription and maintenance fees for our corporate systems. Including capitalized software development costs, total product and development expenses increased as a percentage of revenue to 19.2% in the nine months ended September 30, 2015 as compared to 18.8% in the nine months ended September 30, 2014 due to higher headcount and employee costs.

For the full year 2015, we expect product development expenses as a percentage of revenue to be relatively consistent as we expand our team to develop new features and products and incur a full year impact of personnel hired in 2014.

***Sales and Marketing***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Sales and marketing | $ 42,963 | 32.9% | $ 42,234 | 36.1% | $ 729 | 1.7% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Sales and marketing | $ 143,850 | 38.3% | $ 117,251 | 34.8% | $ 26,599 | 22.7% |

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*For the Three Months Ended September 30, 2015*

Direct marketing expenses were the primary driver for the increase of sales and marketing expenses in the three months ended September 30, 2015 and increased by $1.2 million due to increased pay-per-click advertising, display advertising, affiliate marketing and broad reach media, including television, compared to the three months ended September 30, 2014. Although headcount increased by 16 new employees as of September 30, 2015 compared to September 30, 2014, compensation costs for sales and marketing personnel, including non-cash stock-based compensation, decreased by $0.9 million due to a shift from building the marketing executive team in 2014 to building the sales team in 2015. Overall increases in headcount also drove higher software licenses and maintenance fees for our corporate systems of $0.3 million and an increase of $0.1 million in facilities and depreciation expense.

*For the Nine Months Ended September 30, 2015*

Direct marketing expenses were the primary driver for the increase of sales and marketing expenses as a percentage of revenue in the nine months ended September 30, 2015 and increased by $22.3 million due to increased pay-per-click advertising, display advertising, affiliate marketing and broad reach media, including television. Compensation costs for sales and marketing personnel, including non-cash stock-based compensation, increased by $0.9 million due to the hiring of new employees during the nine months ended September 30, 2015. Overall increases in headcount also drove higher facilities and depreciation expense of $1.1 million. Other increases included $1.9 million in increases in software licenses and maintenance fees for our corporate systems and $0.4 million from travel expenses and professional and consulting fees.

For the full year 2015, we expect sales and marketing expenses in absolute dollars and as a percentage of revenue to increase as we continue to increase our marketing activities to generate additional traveler demand to paid listings, continue to build brand and category awareness, and continue to build our sales team to serve professional property managers.

***General and Administrative***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| General and administrative | $ 23,874 | 18.3% | $ 22,995 | 19.6% | $ 879 | 3.8% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| General and administrative | $ 72,115 | 19.2% | $ 69,467 | 20.6% | $ 2,648 | 3.8% |

*For the Three Months Ended September 30, 2015*

Compensation costs for general and administrative personnel, including non-cash stock-based compensation, increased by $0.6 million due to the addition of 41 new employees and executives in operations, information technology, finance, human resources and legal during the three months ended September 30, 2015 compared to the three months ended September 30, 2014. Overall increases in headcount also drove higher facilities and depreciation expense of $0.2 million and subscription and maintenance fees for our corporate systems of $0.2 million. Furthermore, increased professional fees of $0.6 million were offset by a reduction in our Basic Rental Guarantee Claims expense of $0.8 million.

*For the Nine Months Ended September 30, 2015*

Compensation costs for general and administrative personnel, including non-cash stock-based compensation, increased by $4.5 million due to an increase in new employees and executives in operations, information technology, finance, human resources and legal and a $1.4 million compensation charge, which includes the acceleration of the vesting period for some equity-based awards, associated with the departure of a former executive officer during the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. Overall increases in headcount also drove higher facilities and depreciation expense of $0.7 million and subscription and maintenance fees for our corporate systems of $0.2 million. These increases were offset by a $2.6 million decrease in certain foreign operating taxes. Furthermore, increased professional fees of $0.6 million were offset by a reduction in our Basic Rental Guarantee Claims expense of $0.8 million.

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For the full year 2015, we expect general and administrative expenses as a percentage of revenues to remain consistent or leverage slightly compared to prior periods, excluding any non-recurring expenses associated with the merger agreement with Expedia, Inc. announced on November 4, 2015.

***Amortization***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Amortization expense | $ 2,819 | 2.2% | $ 3,397 | 2.9% | $ (578) | (17.0)% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Amortization expense | $ 8,713 | 2.3% | $ 10,163 | 3.0% | $ (1,450) | (14.3)% |

*For the Three Months Ended September 30, 2015*

The decrease in amortization expense was due to $0.3 million from certain intangible assets becoming fully amortized and $0.3 million from foreign currency changes.

*For the Nine Months Ended September 30, 2015*

The decrease in amortization expense included additional expense of $0.3 million from the addition of intangible assets from the acquisition of Glad to Have You, Inc. in March 2014, offset by a decrease of $1.0 million from certain intangible assets becoming fully amortized and $0.8 million from foreign currency changes.

For the full year 2015, we expect our amortization expenses to decrease in both absolute dollars and as a percentage of revenue as compared to 2014; however, amortization expense could increase as a result of future acquisition activity.

***Other Income (Expense)***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Other income (expense) | $ (4,129) | (3.2)% | $ (5,255) | (4.5)% | $ 1,126 | (21.4)% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Other income (expense) | $ (12,178) | (3.2)% | $ (14,177) | (4.2)% | $ 1,999 | (14.1)% |

*For the Three Months Ended September 30, 2015*

Other expense in the three months ended September 30, 2015 includes interest expense of $4.7 million, partially offset by interest income of $0.9 million, compared to interest expense of $4.4 million partially offset by $0.6 million of interest income in the three months ended September 30, 2014. In addition, other expense in the three months ended September 30, 2015 includes approximately $0.3 million in losses from foreign currency related transactions, compared to losses of $1.4 million in the three months ended September 30, 2014. These losses consist primarily of hedging costs and gains/losses on forward contracts used to hedge

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exposures related to intercompany loans and other assets and liabilities denominated in foreign currencies. These losses also include the re-measurement of certain intercompany loans and other assets and liabilities denominated in foreign currencies that are not hedged.

*For the Nine Months Ended September 30, 2015*

Other expense in the nine months ended September 30, 2015 includes interest expense of $14.0 million, partially offset by interest income of $2.4 million, compared to interest expense of $8.8 million partially offset by $1.1 million of interest income in the nine months ended September 30, 2014. In addition, other expense in the nine months ended September 30, 2015 includes approximately $0.6 million in losses from foreign currency related transactions, compared to losses of $6.4 million in the nine months ended September 30, 2014. These losses consist primarily of hedging costs and gains/losses on forward contracts used to hedge exposures related to intercompany loans and other assets and liabilities denominated in foreign currencies. These losses also include the re-measurement of certain intercompany loans and other assets and liabilities denominated in foreign currencies that are not hedged.

***Income Taxes***

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Income tax expense | $ 5,625 | 4.3% | $ 845 | 0.7% | $ 4,780 | 565.7% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Change | |
| | Amount | Percentage of Revenue | Amount | Percentage of Revenue | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Income tax expense | $ 9,757 | 2.6% | $ 5,909 | 1.8% | $ 3,848 | 65.1% |

*For the Three Months Ended September 30, 2015*

Our income tax expense was $5.6 million for the three months ended September 30, 2015, compared to $0.8 million for the three months ended September 30, 2014. The expense in the three months ended September 30, 2015 was primarily due to tax expense, determined using our estimated annual effective tax rate, offset by certain items recorded discretely in the three months ended September 30, 2015. Those discrete items include a tax benefit due to disqualifying dispositions of incentive stock options, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. The estimated annual effective tax rate at September 30, 2015 differed from the statutory rate primarily due to losses in certain foreign jurisdictions for which a benefit cannot be recorded at this time, non-deductible stock compensation charges, and state taxes, which was partially offset by the benefit of the effect of different statutory tax rates in foreign jurisdictions.

The expense in the three months ended September 30, 2014 was primarily due to tax expense of $3.5 million determined using our estimated annual effective tax rate offset by certain items booked discretely in the three months ended September 30, 2014, including a tax benefit due to disqualifying dispositions of incentive stock options, a tax benefit resulting from the filing of certain 2013 tax returns, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. In addition, the merger of our wholly owned subsidiaries in Spain in the three months ended September 30, 2014 resulted in tax basis intangibles which will be deductible in future periods, with a tax benefit of $2.5 million recorded discretely. The estimated annual effective tax rate at September 30, 2014 differed from the statutory rate primarily due to non-deductible stock compensation charges and state taxes, and is partially offset by the effect of different statutory tax rates in foreign jurisdictions.

*For the Nine Months Ended September 30, 2015*

Our income tax expense was $9.8 million for the nine months ended September 30, 2015, compared to $5.9 million for the nine months ended September 30, 2014. The expense in the nine months ended September 30, 2015 was primarily due to tax expense, determined using our estimated annual effective tax rate, offset by certain items recorded discretely in the nine months ended September 30, 2015. Those discrete items include a tax benefit due to disqualifying dispositions of incentive stock options, a tax benefit due to an income tax reserve release, a tax benefit for adjustments to the recognized value of our federal and Texas research and experimentation tax credit carryforwards, and a tax benefit of $0.4 million related to a correction of an immaterial prior period transfer pricing error, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. The estimated annual effective tax rate at September 30, 2015 differed from the statutory rate primarily due to losses in certain foreign jurisdictions for which a benefit cannot be recorded at this time, non-deductible stock compensation charges, and state taxes, which was partially offset by the benefit of the effect of different statutory tax rates in foreign jurisdictions.

The expense in the nine months ended September 30, 2014 was primarily due to tax expense, determined using our estimated annual effective tax rate, offset by certain items recorded discretely in the nine months ended September 30, 2014, including a tax benefit due to disqualifying dispositions of incentive stock options, a tax benefit for a state tax apportionment change related to a prior period, a tax benefit for adjustments to the recognized value of our federal and Texas research and experimentation tax credit carryforwards, and a tax benefit resulting from the filing of certain 2013 tax returns, offset by tax expense related to the amortization of tax charges on the intercompany sale of assets that were deferred in prior periods. In addition, the merger of our wholly owned subsidiaries in Spain in the three months ended September 30, 2014 resulted in tax basis intangibles which will be deductible in future periods, with a tax benefit of $2.5 million recorded discretely. The estimated annual effective tax rate at September 30, 2014 differed from the statutory rate primarily due to non-deductible stock compensation charges and state taxes, and is partially offset by the effect of different statutory tax rates in foreign jurisdictions.

**Seasonality and Quarterly Results**

Our operating results may fluctuate for a variety of reasons, including seasonal factors and economic cycles that influence the vacation travel market. Property owners and managers tend to buy subscription listings at times when travelers are most likely to make vacation plans. The timing primarily depends on whether travelers are taking a winter or summer vacation and tends to vary by country. Historically, we have experienced the highest level of new and renewed subscription listings in the first quarter of the year, which is typically when travelers are making plans for summer vacations in the United States and Europe. This seasonality results in higher cash flows during the first quarter as most subscription listings are annual and fully paid at the time of purchase or renewal, but may not be seen as prominently in our revenue due to ratable recognition of subscription listing revenue over the listing term.

As we introduce new products for property owners, managers and travelers, including our performance-based pay-per-booking product, the seasonality of those commission-based transactions may vary from the seasonality of our subscription listing sales, and this may result in higher revenues and cash flows in the summer and winter months. We also experience seasonality in the number of visitors to our websites, with the first quarter having the highest number of visitors. This is reflected in our quarterly financial results when we add customer service staff, hosting capabilities and marketing expense to support the increase.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful and historical results may not be indicative of future performance.

**Discussion of Non-GAAP Financial Measures**

This Form 10-Q contains non-GAAP financial measures: Adjusted EBITDA, free cash flow and non-GAAP net income, as defined below, as well as revenue adjusted for foreign currency, which we refer to as constant currency revenue. Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue are financial measures that are not calculated in accordance with GAAP. However, we believe that the use of Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue are useful to investors in evaluating our operating performance for the following reasons:

- our management uses Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue in conjunction with GAAP financial measures as part of our assessment of our business and in communications with our board of directors concerning our financial performance;

- Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue provide consistency and comparability with our past financial performance, facilitate period-to-period comparisons of operations, and also facilitate comparisons with other peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results;

- securities analysts use Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue as supplemental measures to evaluate the overall operating performance of companies; and

- Adjusted EBITDA and non-GAAP net income exclude non-cash charges, such as depreciation, amortization, stock-based compensation and interest expense, because such non-cash expenses in any specific period may not directly correlate to the underlying performance of our business operations and can vary significantly between periods.

Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue should not be reviewed in isolation. You should consider them in addition to, and not as substitutes for, measures of our financial performance reported in accordance with GAAP. Our Adjusted EBITDA, free cash flow, non-GAAP net income or constant currency revenue may not be comparable to similarly titled measures of other companies and because other companies may not calculate such measures in the same manner as we do. Adjusted EBITDA, free cash flow, non-GAAP net income and constant currency revenue have limitations as analytical tools. In addition, none of these measures reflect future requirements for contractual obligations.

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Further limitations of Adjusted EBITDA include:

- this measure does not reflect changes in working capital;
- this measure does not reflect interest income or interest expense; and
- this measure does not reflect cash requirements for income taxes.

We define Adjusted EBITDA as net income (loss) attributable to HomeAway, Inc. plus depreciation, amortization of intangible assets; stock-based compensation expense; interest expense (income); other expense (income), net; income tax expense (benefit); and impact of noncontrolling interests.

The following table presents a reconciliation of net income attributable to HomeAway, Inc. to Adjusted EBITDA (in thousands):

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net income attributable to HomeAway, Inc. | $ 10,417 | $ 4,912 | $ 5,942 | $ 13,222 |
| Depreciation and amortization | 7,997 | 7,595 | 24,917 | 22,254 |
| Stock-based compensation | 12,618 | 12,671 | 37,487 | 35,582 |
| Interest expense | 4,718 | 4,373 | 13,971 | 8,842 |
| Interest income | (927) | (552) | (2,426) | (1,117) |
| Other expense, net | 338 | 1,434 | 633 | 6,452 |
| Income tax expense | 5,625 | 845 | 9,757 | 5,909 |
| Impact of noncontrolling interests, net of tax | (564) | 336 | (709) | (382) |
| Adjusted EBITDA | $ 40,222 | $ 31,614 | $ 89,572 | $ 90,762 |

We define free cash flow as our cash provided by operating activities, adjusted for cash interest expense and excess tax benefit (shortfall) from stock-based compensation, and subtracting capital expenditures. For the purpose of calculating free cash flow, we consider purchases of property, equipment, leasehold improvements for our offices and software licenses, including costs associated with internally developed software, as capital expenditures.

The following table presents a summary of cash flows and a reconciliation of cash flows from operating activities to free cash flows (in thousands):

| | **Three Months Ended September 30,** | **Nine Months Ended September 30,** |
|---|---|---|

| | 2015 | 2014 | 2015 | 2014 |
|---|---|---|---|---|
| Cash provided by operating activities | $ 24,640 | $ 25,527 | $ 119,094 | $ 111,415 |
| Cash paid for interest | 251 | 253 | 503 | 253 |
| Excess tax benefit from stock-based compensation | 5,730 | 1,362 | 8,161 | 2,583 |
| Capital expenditures | (5,675) | (7,107) | (23,792) | (20,456) |
| Free cash flow | $ 24,946 | $ 20,035 | $ 103,966 | $ 93,795 |

We define non-GAAP net income as our net income (loss) attributable to HomeAway, Inc. adjusted for changes to the redemption value of noncontrolling interests, and the after-tax effect of stock-based compensation, amortization of intangible assets, amortization of debt discount and issuance costs, net of amounts capitalized and the impact on noncontrolling interests of these items, utilizing a tax rate of 35%. The income tax effect of adjustments to non-GAAP net income assists investors in understanding the tax provision related to those adjustments using a tax rate of 35% related to ongoing operations.

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The following table presents a reconciliation of net income attributable to HomeAway, Inc. to non-GAAP net income (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income attributable to HomeAway, Inc. | $ 10,417 | $ 4,912 | $ 5,942 | $ 13,222 |
| Add: | | | | |
| Stock-based compensation | 12,618 | 12,671 | 37,487 | 35,582 |
| Amortization expense | 2,819 | 3,397 | 8,713 | 10,163 |
| Amortization of debt discount and issuance costs, net | 4,592 | 4,247 | 13,583 | 8,576 |
| Related tax effect | (7,010) | (7,110) | (20,924) | (19,012) |
| Changes to redemption value of noncontrolling interests | 91 | 851 | 914 | 851 |
| Impact on noncontrolling interests of non-GAAP interests | (38) | (78) | (152) | (218) |
| Non-GAAP net income | $ 23,489 | $ 18,890 | $ 45,563 | $ 49,164 |
| Non-GAAP earnings per share - diluted | $ 0.24 | $ 0.20 | $ 0.47 | $ 0.51 |

We define constant currency revenues as revenue adjusted for foreign currency assuming foreign currency exchange rates used for translation based on the rates in effect for the comparable prior-year period. In order to compute our constant currency revenue, we divide our monthly U.S. dollar revenues by the applicable current year monthly average foreign exchange rates and then multiply those amounts by the applicable prior year monthly average foreign exchange rates.

The following tables present a reconciliation of revenue to constant currency revenue:

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | Change | |
| Revenue | As Reported | Exchange Rate Impact (1) | Constant Currency Revenue (2) | As Reported | Amount | Percent |
| | (dollars in thousands) | | | | | |
| Listing | $ 106,484 | 9,108 | 115,592 | $ 96,601 | $ 18,991 | 19.7% |
| Other | 24,198 | 543 | 24,741 | 20,511 | 4,230 | 20.6 |
| Total | $ 130,682 | $ 9,651 | 140,333 | $ 117,112 | $ 23,221 | 19.8% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | Change | |
| **Revenue** | **As Reported** | **Exchange Rate Impact (1)** | **Constant Currency Revenue (2)** | **As Reported** | **Amount** | **Percent** |
| | | | (dollars in thousands) | | | |
| Listing | $ 301,281 | 26,883 | 328,164 | $ 278,459 | $ 49,705 | 17.9% |
| Other | 74,272 | 1,510 | 75,782 | 58,591 | 17,191 | 29.3 |
| Total | $ 375,553 | $ 28,393 | 403,946 | $ 337,050 | $ 66,896 | 19.8% |

(1) Represents the decrease in reported amounts resulting from changes in foreign exchange rates from those in effect in the comparable prior year period for revenues.

(2) Represents the outcome that would have resulted had foreign exchange rates in the reported period been the same as those in effect in the comparable prior year period for revenues.

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**Supplemental Financial Information**

The following tables present stock-based compensation and depreciation included in the respective line items in our condensed consolidated statements of operations (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| *Stock-based compensation:* | | | | |
| Cost of revenue | $ 881 | $ 847 | $ 2,615 | $ 2,415 |
| Product development | 3,931 | 3,485 | 10,769 | 9,589 |
| Sales and marketing | 3,152 | 2,763 | 9,003 | 7,868 |
| General and administrative | 4,654 | 5,576 | 15,100 | 15,710 |
| Total | $ 12,618 | $ 12,671 | $ 37,487 | $ 35,582 |
| *Depreciation:* | | | | |
| Cost of revenue | $ 1,554 | $ 1,218 | $ 4,922 | $ 3,512 |
| Product development | 1,249 | 1,007 | 3,850 | 2,907 |
| Sales and marketing | 1,589 | 1,373 | 5,090 | 3,970 |
| General and administrative | 786 | 600 | 2,342 | 1,702 |
| Total | $ 5,178 | $ 4,198 | $ 16,204 | $ 12,091 |

**Liquidity and Capital Resources**

From our incorporation in 2004 until March 2014, we financed our operations and acquisitions primarily through private placements of our capital stock and bank borrowings as well as from cash flow generated by the business. In March 2014, we issued $402.5 million in 0.125% convertible senior notes due April 2019 (the Notes ) for net proceeds of $391.6 million after deducting underwriting discounts and other issuance expenses. Concurrent with the issuance of the Notes, we sold warrants to purchase shares of our common stock for cash consideration of $38.3 million, which was offset by the purchase of a convertible note hedge of $85.9 million. The net cash increase in March 2014 from these transactions was $344.0 million.

As of September 30, 2015, our cash, cash equivalents and short-term investments totaled $919.6 million, compared to $813.2 million at December 31, 2014. At September 30, 2015, this amount included assets held in certain of our foreign operations totaling approximately $124.2 million. If these assets were repatriated to the U.S., we may be subject to additional U.S. taxes in certain circumstances. We have not provided for these taxes because we consider these assets to be permanently reinvested in our foreign operations. We have no plans to repatriate the cumulative earnings of our foreign subsidiaries.

We actively monitor the third-party institutions and money market funds that hold these assets, primarily focusing on the preservation of principal while secondarily maximizing investment returns. We diversify our holdings among various financial institutions and money market funds to reduce our exposure to any single counterparty. To date, we have not experienced any material loss or lack of access to our cash or investments; however, we can provide no assurances that access to our cash or investments will not be impacted by future adverse conditions in the financial markets. We have our operating accounts on deposit with third party financial institutions in excess of the Federal Deposit Insurance Corporation insurance limits. While we continually monitor the balances in our operating accounts, these cash balances could be adversely impacted if the underlying financial institutions fail or by other adverse conditions in the financial markets.

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The following table summarizes our cash flows for the periods indicated:

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| | (in thousands) | |
| **Consolidated Statements of Cash Flow Data:** | | |
| Net cash provided by operating activities | $ 119,094 | $ 111,415 |
| Net cash used in investing activities | (118,573) | (506,511) |
| Net cash provided by financing activities | 17,801 | 367,894 |
| Effect of exchange rate changes on cash and cash equivalents | (9,354) | (5,303) |
| Net increase (decrease) in cash and cash equivalents | 8,968 | (32,505) |
| Cash and cash equivalents at beginning of period | 292,325 | 324,608 |
| Cash and cash equivalents at end of period | $ 301,293 | $ 292,103 |

***Net Cash Provided by Operating Activities***

In the nine months ended September 30, 2015, cash was generated primarily through an increase in new and renewed subscription listings, resulting in higher upfront collection of listing fees and increased deferred revenue of $29.7 million. During the nine months ended September 30, 2015, we generated a net income of $5.2 million. Included in our net income was depreciation expense of $16.2 million, amortization expense of $8.7 million, amortization of debt discount and transaction costs of $13.8 million and non-cash stock-based compensation expense of $37.5 million. In addition, cash flow from operations was reduced by excess tax benefit from stock-based compensation of $8.2 million and a decrease in non-cash deferred income taxes of $1.4 million. Net income, excluding these non-cash reductions, contributed $71.9 million to cash provided by operating activities during the nine months ended September 30, 2015.

In the nine months ended September 30, 2014, cash was generated primarily through an increase in new and renewed subscription listings, resulting in higher upfront collection of listing fees and increased deferred revenue of $25.4 million. During the nine months ended September 30, 2014, we generated net income of $12.8 million. Included in our net income was depreciation expense of $12.1 million, amortization expense of $10.2 million, amortization of debt discount and transaction costs of $8.7 million and non-cash stock-based compensation of $35.6 million. Net income, excluding these non-cash reductions, contributed $79.4 million to cash provided by operating activities.

The growth in our number of paid listings, the impact of other revenue and expenses, the timing and amount of future working capital changes and tax payments will affect the future amount of cash used in or provided by operating activities.

***Net Cash Used in Investing Activities***

In the nine months ended September 30, 2015, capital expenditures were $23.8 million and included $6.9 million in capitalized software development costs. Purchases of short-term investments, net of proceeds received from the sale and maturities of short-term investments were $105.8 million. Additionally, we invested $3.9 million for non-controlling equity interests in privately held vacation rental website companies in Turkey and Canada.

During the nine months ended September 30, 2014, we invested $16.8 million, net of cash acquired, in the acquisition of Glad to Have You, Inc. Capital expenditures were $20.5 million and included $6.4 million in capitalized software development costs. Purchases of short-term investments, net of proceeds received from the sale and maturities of short-term investments, were $445.9 million and cash outflows related to the net settlement of foreign currency forwards were $12.0 million. We also increased our minority stake in a privately held company in China for $9.4 million.

As our business expands, we expect to invest in new computers and software for employees, for product development and to support the hosting of our websites. As we expand our facilities to support a growing employee base, we intend to purchase furniture and fixtures and invest in leasehold improvements. We may have acquisitions in the future that could have a material impact on our cash flows and operations. Our planned capital expenditures are not expected to exceed $35.0 million in 2015.

***Net Cash Provided by Financing Activities***

Cash provided by financing activities in the nine months ended September 30, 2015 was comprised of proceeds from the exercise of stock options to purchase common stock of $9.6 million and $8.2 million of cash provided from the excess tax benefits from stock-based compensation.

Cash provided by financing activities during the nine months ended September 30, 2014 was primarily comprised of $391.0 million in net proceeds from the issuance of the Notes. Additionally, we received proceeds of $38.3 million from the sale of warrants to acquire shares of our common stock and paid $85.9 million for a convertible note hedge transaction. Proceeds from the exercise of stock options to purchase common stock were $22.8 million in the nine-month period ended September 30, 2014. Additionally, in the nine-month period ended September 30, 2014, $2.6 million of cash provided was related to excess tax benefits from stock-based compensation.

*Capital Resources*

Based on past performance and current expectations, we believe our existing cash and investments plus future cash generated from operations will be sufficient to satisfy our cash requirements through at least the next 12 months.

Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our marketing and sales activities, the extent of product development efforts, the introductions of new products and services, enhancements to existing products and services, potential acquisitions and the continuing market acceptance of our products and services. We may need to raise additional capital through future debt or equity financing to fund such activities. Additional financing may not be available at all or on favorable terms. We may enter into arrangements in the future with respect to investments in, or acquisitions of, complementary businesses, products, services or technologies which could also require additional equity or debt financing.

**Contractual Obligations and Commitments**

The majority of our property owners and managers pay for their subscription listings by credit card because it simplifies and expedites the payment process and is a relatively secure form of payment. We have multiple agreements with credit card companies to support these activities. Most of our property owners and managers purchase an annual listing, for which payment is made at the beginning of the listing. There is a risk that we may fail to fully perform our obligations under the listing, which could result in an obligation of the credit card companies to reimburse their customers for a portion, or all, of the listing fee. We would be obligated to reimburse the credit card companies for all such amounts they pay pursuant to our agreements with them, under which we have obtained our credit card acceptance privileges.

As of September 30, 2015, we have amounts held in restricted cash to fund payments received on behalf of property owners, to protect banks from default on credit cards and direct debits used in our operations and to support bank guarantees related to our office leases. As bookings continue to increase, as we make changes to our credit card merchants and acquiring banks and as we enter into new leases, we may have increases to restricted cash and deposits.

As of September 30, 2015, we have reserved $9.9 million for uncertain tax positions, including interest and penalties. We are unable to make a reasonably reliable estimate as to when or if cash settlement with taxing authorities will occur. For additional information regarding uncertain tax positions, see Note 12 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2014.

For a discussion of the Notes due April 1, 2019, please see Note 5 in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

**Off-Balance Sheet Arrangements**

During the nine month period ended September 30, 2015, we did not, and we do not currently, have any relationships with unconsolidated entities or financial partnerships, including entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes that have, or are reasonably likely to have, a current or future material effect on our consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources.

**Recent Accounting Pronouncements**

See Note 2 in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, for a full description of recent accounting pronouncements which is incorporated herein by reference.

**Item 3: Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk for the effect of interest rate changes, foreign currency fluctuations and changes in the market values of our investments and the Notes. Information relating to quantitative and qualitative disclosures about market risk is set forth above and in Item 2 of Part I, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

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*Foreign currency exchange risk.* We have foreign subsidiaries that generally use the local currency as their functional currency, which we translate into U.S. dollars for consolidation. Our results of operations and cash flows are subject to fluctuations due to changes in exchange rates involving the Euro, British Pound, Brazilian Real, Australian Dollar, Singapore Dollar and New Zealand Dollar, among others. We currently enter into forward contracts to hedge fluctuations in the value of certain intercompany debt denominated in foreign currencies but do not enter into any other derivative financial instruments for trading or speculative purposes. Following our acquisition of Stayz.com.au, our intercompany debt denominated in foreign currencies has increased significantly.

Fluctuations in currency exchange rates could result in translation gains and losses when we consolidate our results and harm our business in the future. Because we conduct a significant and growing portion of our business outside the United States but report our results in U.S. dollars, we face exposure to adverse movements in currency exchange rates, which may cause our revenue and operating results to differ materially from expectations. For example, if the U.S. dollar strengthens relative to the Euro, British Pound, Brazilian Real, Australian Dollar, Singapore Dollar or New Zealand Dollar, our non-U.S. revenue and operating results would be adversely affected when translated into U.S. dollars. Conversely, a decline in the U.S. dollar relative to these foreign currencies would increase our non-U.S. revenue and operating results when translated into U.S. dollars.

The effect of an immediate 10% adverse change in exchange rates on foreign denominated cash and receivables as of September 30, 2015 would result in a loss of approximately $1.8 million and a reduction in value on the balance sheet of approximately $13.4 million.

*Convertible senior notes and interest rate risk.* In March 2014, we issued $402.5 million of 0.125% convertible senior notes due April 1, 2019. We carry this instrument at face value less unamortized discount on our balance sheet. Because this instrument bears interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of this instrument fluctuates when interest rates change and when the market price of our stock fluctuates.

*Investments and interest rate sensitivity.* The primary objective of our investment activities is to preserve principal while also maximizing yields without significantly increasing risk. To achieve this objective and minimize our exposure to an adverse shift in interest rates, we invest in short-term, high-quality, interest-bearing securities. To provide a meaningful assessment of the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of our investment portfolio assuming a 100 basis point increase in interest rates. As of September 30, 2015, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $5.2 million incremental decline in the fair market value of our portfolio.

We have non-controlling investments in the equity of privately-held companies in Turkey, Canada, China and the United States. Because our ownership interest is less than 20 percent and we do not have the ability to exert significant influence, we account for these non-marketable equity investments using the cost method of accounting. As of September 30, 2015, the carrying value of these investments was $39.3 million.

## Item 4: Controls and Procedures

### *Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2015. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2015, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at a reasonable assurance level.

***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2015, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we may become involved in litigation related to claims arising from the ordinary course of our business. We believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

### Item 1A. Risk Factors.

### Risks Related to Our Business

The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe are immaterial may also impair our business, results of operations or financial condition.

***If we are unable to attract and maintain a critical mass of vacation rental listings and travelers, whether due to competition or other factors, our marketplace will become less valuable to property owners and managers and to travelers, and our revenue and net income could decrease materially.***

Most of our revenue is generated when owners or managers of vacation rentals pay us listing fees, by subscription or a booking commission, to list and market vacation rentals to travelers who visit our online marketplace. Accordingly, our success primarily depends on our ability to attract owners, managers, travelers and advertisers to our marketplace. If property owners and managers choose not to market their vacation rentals through our websites, or instead list them with a competitor, we may be unable to offer a sufficient supply and variety of vacation properties to attract travelers to our websites. Similarly, our volume of new listings and listing renewals may suffer if we are unable to attract travelers to our websites. If we are unable to attract owners and travelers to our websites, advertisers may not purchase display advertising on our websites. As a result of any of these events, the perceived usefulness of our online marketplace is likely to decline, and our revenue and net income could decrease materially.

***Our business depends substantially on property owners and managers renewing their subscription listings. Because we recognize revenue over the term of the applicable agreement, the lack of subscription-based listing renewals may not immediately be reflected in our operating results.***

Our business depends substantially on property owners and managers renewing their subscription listings. Any decline in our subscription listing renewals could harm our operating results. Property owners and managers generally market their vacation rentals on our websites pursuant to prepaid annual subscription listings with no obligation to renew. We may be unable to predict future listing renewal rates accurately, and our renewal rates may decline materially or fluctuate as a result of a number of factors. These factors include property owners decisions to sell or to cease renting their properties, their decisions to use the services of our competitors, or their dissatisfaction with our pricing, fees, products, services or websites. Property owners and managers may not establish or renew subscription listings if we cannot generate visits from large numbers of travelers seeking, inquiring about or booking vacation rentals.

In addition, from time to time we make changes that impact our customers, including changes to listings available features, the software tools we offer owners and managers in their operations, our pricing, fees, and the algorithms that determine the listings ranking in search query results. While such changes may be intended to improve customer satisfaction, there can be no guarantee that the changes will perform as expected or that property owners and managers will react positively and continue to renew their listings. For example, we offer different subscription levels on many of our websites and property owners and managers may not be satisfied with the subscription level that is available or they purchase. We also offer on certain websites the ability for property owners and managers to list on a commission basis without paying a subscription fee. Subscription-based customers may choose not to renew their subscriptions and list on a commission basis, which could result in decreased revenue. If property owners and managers do not renew their subscription listings at the same level or at all, or if we are forced to offer renewals on less favorable terms, our revenue could decline and our business could suffer.

We recognize subscription listing revenue ratably over the term of the applicable listing agreement, and the majority of our quarterly revenue represents revenue attributable to listings entered into during previous quarters. As a result, the effect of significant downturns in new or renewed subscription listings in a particular quarter will not be fully reflected in our results of operations until future periods. Our business model also makes it difficult for any rapid increase in new or renewed listings to increase our revenue in any one period because revenue from new and renewed subscription listings must be recognized over the applicable listing term.

Moreover, some of our property owners and managers may live in states or countries that give subscribers the right to cancel their subscriptions prior to expiration and receive refunds for the unused portions of their subscriptions. Termination of subscriptions in this manner may adversely affect our cash flows.

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***Our quarterly financial results and key operating metrics are subject to fluctuations. As a result, we could fail to meet our projections or the expectations of analysts or investors, which could cause our stock price to decline.***

Our revenue, expenses, operating results and cash flows, as well as our key operating metrics, have fluctuated from quarter to quarter in the past and are likely to continue to do so in the future. These fluctuations are due to, or may result from, many factors, some of which are outside of our control and many of which are difficult to predict. These factors include:

- the quantity of vacation rental listings on our websites;
- the timing and success of changes in our pricing, fees or services;
- the introduction and performance of new products or services;
- advertising costs for paid search keywords and other online or broad reach advertising and marketing initiatives;
- the amount and timing of financing activities, operating expenses and capital expenditures;
- changes in cash flow due to the seasonal nature of our listing renewals and new listing acquisition;
- changes in cash flow due to customers purchasing commission-based listings, the timing and quantity of which are difficult to predict;
- changes in revenue due to the irregular timing of commissions earned on our performance-based listings;
- economic instability abroad and fluctuations in exchange rates;
- changes by major online search engine companies in their search algorithms, which could increase expenses related to marketing and search engine optimization, or could cause our websites positions in search results to suffer;
- the timing of revenue and expenses related to the licensing, development, acquisition and integration of technologies, products, services or businesses, including expenses for such strategic business acquisitions which may not be finally completed;

- the introduction of new products or services by our competitors;
- development of or increases in fraud impacting our property owners and managers and travelers, including theft of online identities through phishing or other system security breaches;
- declines or disruptions in the travel industry, particularly in regions where we generate substantial revenue;
- changes in the timing of holidays or other vacation events;
- litigation and settlement costs, including unforeseen attorneys fees and costs;
- new accounting pronouncements and changes in accounting standards or practices, particularly any affecting the recognition of listing revenue or accounting for mergers and acquisitions; and
- new laws or regulations, or interpretations of existing laws or regulations, that harm our business models or restrict the vacation rental industry, the Internet, e-commerce, online payments, or online communications.

Fluctuations in our quarterly operating results may, particularly if unforeseen, cause us to miss any projections we may have provided or may lead analysts or investors to change their valuation of our stock. In addition, such fluctuations may cause us to face short-term liquidity issues, impact our ability to retain or attract key personnel or cause other unanticipated issues. Any of these effects could cause our stock price to decline. As a result of the potential variability in our quarterly revenue and operating results, we believe that quarter-to-quarter comparisons of our revenue and operating results may not be meaningful and the results of any one quarter should not be relied upon as an indication of future performance.

***If we are unable to continue to drive visitors to our websites from search engines, then traffic to our websites could decrease, which could negatively impact transactions on our websites and therefore cause our revenue to decrease.***

Many visitors find our websites by searching for vacation rental information through Internet search engines. A critical factor in attracting visitors to our websites is how prominently we are displayed in response to search queries. Accordingly, we utilize search engine marketing, or SEM, as a means to provide a significant portion of our visitor acquisition. SEM includes both paid visitor acquisition (on a cost-per-click basis) and unpaid visitor acquisition, which is often referred to as organic search.

One method we employ to acquire visitors via organic search is commonly known as search engine optimization, or SEO. SEO involves developing our websites in order to rank highly in relevant search queries. In addition to SEM and SEO, we may also utilize other forms of marketing to drive visitors to our websites, including branded search, display advertising and email marketing.

The various search engine providers, such as Google and Bing, employ proprietary algorithms and other methods for determining which websites are displayed for a given search query and how highly websites rank. Search engine providers may change these methods in a way that may negatively affect the number of visitors to our websites and may do so without public announcement or detailed explanation. Therefore, the success of our SEO and SEM strategy depends, in part, on our ability to anticipate and respond to such changes in a timely and effective manner.

In addition, websites must comply with search engine guidelines and policies. These guidelines and policies are complex and may change at any time. If we fail to follow such guidelines and policies properly, the search engine may cause our content to rank lower in search results or could remove the content altogether. If we fail to understand and comply with these guidelines and policies and ensure our websites compliance, our SEO and SEM strategy may not be successful.

If we are listed less prominently or fail to appear in search result listings for any reason, including as a result of our failure to successfully execute our SEO and SEM strategy, it is likely that we will acquire fewer visitors to our websites. Fewer visitors to our websites could lead to property owners and managers becoming dissatisfied with our websites, as well as fewer travelers inquiring and booking through our websites, either or both of which could adversely impact our revenue. We may not be able to replace this traffic in a cost-effective manner from other channels, such as cost-per-click SEM or display or other advertising, or even at all. Any attempt to replace this traffic through other channels may increase our sales and marketing expenditures, which could adversely affect our operating results.

***If we are unable to introduce new or upgraded products, services or features that travelers or property owners and managers recognize as valuable, we may fail to drive additional travelers to our websites or retain existing and attract new property owners and managers. Our efforts to develop new and upgraded services and products could require us to incur significant costs.***

In order to continue to attract travelers to our online marketplace and retain existing and attract new property owners and managers, we will need to continue to invest in the development of new products, services and features that add value for travelers, property owners and managers and/or differentiate us from our competitors. The success of new products, services and features depends on several factors, including the timely completion, introduction and market acceptance of the product, service or feature. If travelers, property owners or managers do not recognize the value of our new services or features, they may choose not to utilize or list on our online marketplace.

Attempting to develop and deliver these new or upgraded products, services or features involves inherent hazards and difficulties, and is costly. Efforts to enhance and improve the ease of use, responsiveness, functionality and features of our existing websites have inherent risks, and we may not be able to manage these product developments and enhancements successfully. We cannot assure that we will succeed or that new or upgraded products, services or features will work as intended or provide value. In addition, some new or upgraded products, services or features may be difficult for us to market and may also involve unfavorable pricing or fees. Even if we succeed, we cannot guarantee that our property owners and managers will respond favorably.

In addition to developing our own improvements, we may choose to license or otherwise integrate applications, content and data from third parties. The introduction of these improvements imposes costs on us and creates a risk that we may be unable to continue to access these technologies and content on commercially reasonable terms, or at all.

***Unfavorable changes in, or interpretations of, government regulations or taxation of the evolving vacation rental, Internet and e-commerce industries could harm our operating results.***

We operate in markets throughout the world, in jurisdictions which have various regulatory and taxation requirements that can affect our operations or regulate the rental activity of property owners and managers. Compliance with laws and regulations of different jurisdictions imposing different standards and requirements is very burdensome because each region in which we operate has different regulations with respect to licensing and other requirements for the listing of vacation rentals. Our online marketplace is accessed by property owners, managers and travelers in multiple states and foreign jurisdictions. Our business efficiencies and economies of scale depend on generally uniform treatment of property owners, managers and travelers across all jurisdictions in which we operate. Compliance requirements that vary significantly from jurisdiction to jurisdiction impose an added cost to our business and increased liability for compliance deficiencies. In addition, laws or regulations that may harm our business could be adopted, or reinterpreted in a manner that affects our activities, including but not limited to the regulation of personal and consumer information and real estate licensing requirements. Violations or new interpretations of these laws or regulations may result in penalties, negatively impact our operations and damage our reputation and business.

In addition, since we began our operations in 2005, there have been, and continue to be, regulatory developments that affect the vacation rental industry and the ability of companies like us to list those vacation rentals online. For example, some municipalities have adopted ordinances that limit the ability of property owners and managers to rent certain properties for fewer than 30 consecutive days and other cities may introduce similar regulations. Some cities also have fair housing or other laws governing whether and how properties may be rented, which they assert apply to vacation rentals. Many homeowners, condominium and neighborhood associations have adopted rules that prohibit or restrict short-term vacation rentals. In addition, many of the fundamental statutes and regulations that impose taxes or other obligations on travel and lodging companies were established before the growth of the Internet and e-commerce, which creates a risk of these laws being used in ways not originally intended that could burden property owners and managers or otherwise harm our business. These and other similar new and newly interpreted regulations could increase costs for, or otherwise discourage, owners and managers from listing on our websites, which could harm our business and operating results.

From time to time, we may become involved in challenges to, or disputes with government agencies regarding, these regulations. For example, some government agencies have asked us directly to comply with their regulations and provide owner and manager data to assist them in their enforcement and audit efforts. There can be no assurance that we will be successful in defending against the application of these laws and regulations. Further, if we were required to comply with regulations and government requests that negatively impact our relations with property owners, managers and travelers, our business, operations and financial results could be adversely impacted.

Additionally, new, changed, or newly interpreted or applied tax laws, statutes, rules, regulations or ordinances could increase our property owners and managers and our compliance, operating and other costs. This, in turn, could deter property owners and managers from renting their vacation properties, negatively affect our new listings and subscription renewals, or increase costs of doing business. Any or all of these events could adversely impact our business and financial performance.

Furthermore, as we expand or change the products and services that we offer or the methods by which we offer them, we may become subject to additional legal regulations, tax requirements or other risks. Regulators may seek to impose regulations and requirements on us even if we utilize third parties to offer the products or services. These regulations and requirements may apply to payment processing, insurance products or the various other products and services we may now or in the future offer or facilitate through our marketplace. Whether we comply with or challenge these additional regulations, our costs may increase and our business may otherwise be harmed.

***If we are not able to maintain and enhance our HomeAway brand and the brands associated with each of our websites, our reputation and business may suffer.***

It is critical for us to maintain and enhance our brand identity in order to attract and retain property owners, managers and travelers. The successful promotion of our brands will depend largely on our marketing and public relations efforts. We expect that the promotion of our brands will require us to make substantial investments, and, as our market becomes more competitive, these branding initiatives may become increasingly difficult and expensive. In addition, we may not be able to successfully build our HomeAway brand identity in the United States and overseas without losing value associated with, or decreasing the effectiveness of, our other brand identities. If we do not successfully maintain and enhance our brands, we could lose traveler traffic, which could, in turn, cause property owners and managers to terminate or elect not to renew their listings with us. In addition, our brand promotion activities may not be successful or may not yield revenue sufficient to offset their cost, which could adversely affect our reputation and business.

***Our long-term success depends, in part, on our ability to expand our property owner, manager and traveler bases outside of the United States and, as a result, our business is susceptible to risks associated with international operations.***

As our operations have expanded, we have acquired businesses or established offices around the world. As of September 30, 2015, we maintain offices in the United States, Europe, South America, Australia and Asia and operate websites in several additional countries and regions. We have limited operating and e-commerce experience in many foreign jurisdictions and are making significant investments to build our international operations. We plan to continue our efforts to expand globally, including acquiring international businesses and conducting business in jurisdictions where we do not currently operate, including increasing our focus on the Asia Pacific region. However, we may from time to time also reduce the locations of our physical operations if we believe it would create efficiencies in doing so and there can be no guarantee that the locations where we choose to operate will be the most efficient or that they will not create additional risks. Managing a global organization is difficult, time consuming and expensive and any international expansion efforts that we undertake may not be profitable in the near or long term or otherwise be successful. In addition, conducting international operations subjects us to risks that we generally do not face in the United States. These risks include:

- the cost and resources required to localize our services, which requires the translation of our websites and their adaptation for local practices and legal and regulatory requirements;
- adjusting the products and services we provide in foreign jurisdictions, as needed, to better address both the needs of local owners and travelers, and the threats of local competitors;
- being subject to foreign laws and regulations, including those laws governing Internet activities, email messaging, collection and use of personal information, ownership of intellectual property, taxation and other activities important to our online business practices, which may be less developed, less predictable, more restrictive, and less familiar, and which may adversely affect financial results in certain regions;
- competition with companies that understand the local market better than we do or who have pre-existing relationships with property owners, managers and travelers in those markets;
- legal uncertainty regarding our liability for the transactions and content on our websites, including online bookings, property listings and other content provided by property owners and managers, including uncertainty resulting from unique local laws or a lack of clear precedent of applicable law;

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- lack of familiarity with and the burden of complying with a wide variety of other foreign laws, legal standards and foreign regulatory requirements, including invoicing, data collection and storage, financial reporting and tax compliance requirements, which are subject to unexpected changes;
- laws and business practices that favor local competitors or prohibit or limit foreign ownership of certain businesses;
- challenges associated with joint venture relationships and minority investments;
- adapting to variations in foreign payment forms;
- difficulties in managing and staffing international operations and establishing or maintaining operational efficiencies;
- difficulties in establishing and maintaining adequate internal controls and security over our data and systems;
- currency exchange restrictions and fluctuations in currency exchange rates;
- potentially adverse tax consequences, which may be difficult to predict, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- increased financial accounting and reporting burdens and complexities and difficulties in implementing and maintaining adequate internal controls;
- political, social and economic instability abroad, war, terrorist attacks and security concerns in general;
- the potential failure of financial institutions internationally;
- reduced or varied protection for intellectual property rights in some countries; and
- higher telecommunications and Internet service provider costs.

Operating in international markets also requires significant management attention and financial resources. We cannot guarantee that our international expansion efforts in any or multiple territories will be successful. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability and could instead result in increased costs.

***The market in which we participate is highly competitive, and we may be unable to compete successfully with our current or future competitors.***

The market to provide listing, search and marketing services for the vacation rental industry is very competitive and highly fragmented. In addition, the barriers to entry are low and new competitors may enter. All of the services that we provide to property owners, managers and travelers, including listing and search, are provided separately or in combination by current or potential competitors. Our competitors may adopt aspects of our business model, which could reduce our ability to differentiate our services. Additionally, current or new competitors may introduce new business models or services that we may need to adopt or otherwise adapt to in order to compete, which could reduce our ability to differentiate our business or services from those of our competitors. Furthermore, properties in the vacation rental industry are not typically marketed exclusively through any single channel, and our listing agreements are not typically exclusive. Accordingly, our competitors could aggregate a set of listings similar to ours. Increased competition could result in a reduction in revenue, rate of new listing acquisition, existing listings or market share.

There are thousands of vacation rental listing websites that compete directly with us for listings, travelers, or both, such as HouseTrips.com, Booking.com, Airbnb, @Leisure, InterHome, TripAdvisor and Wyndham Worldwide. Many of these competitors offer free or heavily discounted listings or focus on a particular geographic location or a specific type of rental property. Some of them also aggregate property listings obtained through various sources, including the websites of property managers some of whom also market their properties on our websites.

Competitors also operate websites directed at the wider fragmented travel lodging market, such as Airbnb (worldwide) and Wimdu (worldwide), by listing either rooms or the owner s primary home. These properties increase both the number of rental opportunities available to travelers and the competition for the attention of the traveler. Some vacation rental property owners and managers also list on these websites, and consequently these companies currently compete with us to some extent.

We also compete with online travel agency websites, such as Expedia, Hotels.com, Kayak, Priceline, Booking.com, Orbitz and Travelocity, which have traditionally provided comprehensive travel services and some of whom are now expanding into the vacation rental category. We also compete with large Internet search companies, such as craigslist, eBay, Google, MSN.com and Yahoo!, which provide listing or advertising services in addition to a wide variety of other products or services. In addition, some competitors, such as Perfect Places, Inc. and VacationRoost, Inc. in the United States and Atraveo and eDomizil in Europe, predominately serve the professional property manager marketplace, and therefore have the ability to create more products and features targeted to property managers. Hotels, corporate travel providers, travel metasearch engines, travel content aggregators, mobile platform travel applications, social media websites, and even mobile computing hardware providers all also have the potential to increase their competitive presence in the areas of our business as well.

We believe we compete primarily on the basis of the quantity and quality of our listings, the quality of the direct relationships we have with property owners and managers, the volume of travelers who visit our websites, the number of inquiries provided to our property owners and managers, the global diversity of the vacation rentals available on our websites, the quality of our websites, the tools provided to our property owners and managers to assist them with their business, customer service, brand identity, the success of our marketing programs, and price. If current or potential property owners, managers or travelers choose to use any of these competitive offerings in lieu of ours, our revenue could decrease and we could be required to make additional expenditures to compete more effectively. Any of these events or results could harm our business, operating results and financial condition.

In addition, some of our current or potential competitors are larger and have more resources than we do. Many of our current and potential competitors enjoy substantial competitive advantages, such as greater name recognition in their markets, longer operating histories and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, our current or potential competitors may have access to larger property owner, manager or traveler bases. As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or owner, manager or traveler requirements. Furthermore, because of these advantages, existing and potential owners, managers and travelers might accept our competitors offerings, even if they may be inferior to ours. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

***If our cost efficiency measures are not successful, we may become less competitive.***

We continue to focus on minimizing our operating expenses through cost improvements and simplifying our structure. However, certain factors may prevent the achievement of these goals, which may in turn negatively affect our competitive position. For example, we may experience delays or unanticipated costs in implementing our cost efficiency plans. As a result, we may not achieve our expected cost efficiencies in the time or to the extent anticipated.

***If the businesses we have acquired or invested in do not perform as expected or we are unable to effectively integrate acquired businesses, our operating results and prospects could be harmed.***

As of September 30, 2015, we have acquired 22 businesses and currently have equity investments in four companies. The businesses we have acquired or invested in may not perform as well as we expect. Failure to manage and successfully integrate recently acquired businesses and technologies could harm our operating results and our prospects. If the companies we have invested in do not perform well, our investments could become impaired and our financial results could be negatively impacted.

Our mergers and acquisitions involve numerous risks, including the following:

- difficulties in integrating and managing the combined operations, technologies, technology platforms and products of the acquired companies and realizing the anticipated economic, operational and other benefits in a timely manner, which could result in substantial costs and delays or other operational, technical or financial problems;

- legal or regulatory challenges or post-acquisition litigation, which could result in significant costs or require changes to the businesses or unwinding of the transaction;

failure of the acquired company to achieve anticipated revenue, earnings or cash flow;

diversion of management s attention or other resources from our existing business;

our inability to maintain the key customers and business relationships, and the reputations of acquired businesses;

uncertainty resulting from entering markets in which we have limited or no prior experience or in which competitors have stronger market positions;

our dependence on unfamiliar affiliates and partners of acquired businesses;

unanticipated costs associated with pursuing acquisitions;

liabilities of acquired businesses, which may not be disclosed to us or which may exceed our estimates, including liabilities relating to non-compliance with applicable laws and regulations, such as data protection and privacy controls;

difficulties in assigning or transferring to us or our subsidiaries intellectual property licensed to companies we acquired;

difficulties in maintaining our internal standards, controls, procedures and policies including financial reporting requirements of the Sarbanes-Oxley Act of 2002 and extending these controls to acquired companies;

potential loss of key employees of the acquired companies;

difficulties in complying with antitrust and other government regulations;

challenges in integrating and auditing the financial statements of acquired companies that have not historically prepared financial statements in accordance with U.S. generally accepted accounting principles; and

potential accounting charges to the extent intangibles recorded in connection with an acquisition, such as goodwill, trademarks, customer relationships or intellectual property, are later determined to be impaired and written down in value.

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Moreover, we rely heavily on the representations and warranties provided to us by the sellers of acquired companies, including as they relate to creation, ownership and rights in intellectual property, existence of open source software and compliance with laws and contractual requirements. If any of these representations and warranties are inaccurate or breached, such inaccuracy or breach could result in costly litigation and assessment of liability for which there may not be adequate recourse against such sellers, in part due to contractual time limitations and limitations of liability.

***We may be unable to effectively manage our growth.***

Since our inception, we have experienced rapid growth. As our operations have expanded, we have grown from 87 employees at December 31, 2005 to 1,900 employees at September 30, 2015, of whom 711 were located outside the United States. This includes employees of entities for which we have a controlling interest. Our business is becoming increasingly complex, especially in light of the continued rapid evolution of our industry and e-commerce, and our reliance on multiple websites throughout the world. This complexity and our rapid growth have demanded, and will continue to demand, substantial resources and attention from our management. We may need to increase headcount and to hire more specialized personnel in the future as we grow our business. We may also need to hire, train and manage additional qualified website developers, software engineers, client and account services personnel, and sales and marketing staff and improve and maintain our technology to properly manage our growth. If our new hires perform poorly, if we are unsuccessful in hiring, training, managing and integrating these new employees or if we are not successful in retaining our existing employees, our business may be harmed.

Further, to accommodate our expected growth we must add new hardware and software and improve and maintain our technology, systems and network infrastructure. Failure to effectively upgrade our technology or network infrastructure to support the expected increased listing and traveler traffic volume could result in unanticipated system disruptions, slow response times or poor experiences for property owners, managers or travelers. To manage the expected growth of our operations and personnel and to continue to support our public company financial reporting and internal control requirements, we will need to continue to improve our transaction processing and reporting, operational and financial systems, procedures and controls. These improvements will be particularly challenging if we acquire new operations with different systems. Our current and planned personnel, systems, procedures and controls may not be adequate to support our future operations. If we are unable to expand our operations and hire additional qualified personnel in an efficient manner, it could adversely affect property owner, manager, traveler or advertiser satisfaction and revenue and operating income as a result.

***We have a relatively limited operating history and we operate in a rapidly evolving industry, which make it difficult to evaluate our current business and future prospects. If we fail to predict the manner in which our business will perform or how the market will develop, our business and prospects may suffer materially.***

We began our operations in February 2005. Our relatively limited operating history, together with our rapidly changing industry, may make it difficult to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries. These include challenges in accurate financial planning and forecasting as we develop new products or strategic plans, such as our online booking initiative and value added services like insurance and property damage protection and payment processing capabilities, with little or no historical reference as a basis for such planning and forecasting. Our business and prospects should be considered in light of the risks and difficulties we may encounter as a company operating in a highly competitive environment where changes to our business, plans, and products may be required to respond to such changes.

In addition, the market for online vacation rentals is relatively new and, in many geographies, is unproven with little data or research available regarding the market and industry. It is uncertain whether the vacation rental market in many territories where we do business will continue to develop or if our services will achieve and sustain a level of demand and market acceptance sufficient for us to generate revenue, net income and cash flow growth, at anticipated levels or at all. Even in territories where we currently do business, we may need to focus on or offer different types of products and services in order to remain competitive. Our success will depend to a substantial extent on the willingness of property owners and managers to use commercial online rental property listing services. Some property managers have developed and use their own proprietary online listing services and, therefore, may be reluctant or unwilling to use our websites to market their properties. Furthermore, some travelers and property owners and managers may be reluctant or unwilling to use online listing services because of concerns regarding the security of data, the potential for fraudulent activity, including phishing, or the integrity of the online marketplace. If property owners and managers do not perceive the benefits of marketing their properties online, then our market may not develop as we expect, or it may develop more slowly than we expect, either of which could significantly harm our business and operating results. Moreover, our success will depend on travelers use of our online marketplace to search, locate and rent vacation rentals, which will depend on their willingness to use the Internet and their belief in the integrity of our websites. In addition, because we operate in unproven and unstudied markets, we have limited insight into trends that may develop in those markets and may affect our business. We may make errors in predicting and reacting to other relevant business trends, which could harm our business.

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***Changes in our effective tax rate could harm our future operating results.***

We are subject to federal and state income taxes in the United States and in various foreign jurisdictions. Our provision for income taxes and our effective tax rate are subject to volatility and could be adversely affected by several circumstances, including:

- earnings being lower than anticipated in countries that have lower tax rates and higher than anticipated in countries that have higher tax rates;
- effects of certain non-tax deductible expenses, including those arising from the requirement to expense stock options;
- changes in the valuation of our deferred tax assets and liabilities;
- expiration of or lapses in the research and development tax credit laws;
- transfer pricing adjustments, including the effect of acquisitions on our intercompany research and development cost sharing arrangement and legal structure;
- adverse outcomes resulting from any tax audit;
- our ability to utilize our net operating losses and other deferred tax assets; and
- changes in accounting principles or changes in tax laws and regulations, or the application of the tax laws and regulations, including possible U.S. changes to the taxation of earnings of our foreign subsidiaries, the deductibility of expenses attributable to foreign income, or the foreign tax credit rules.

Significant judgment is required in the application of accounting guidance relating to uncertainty in income taxes. If tax authorities challenge our tax positions and any such challenges are settled unfavorably, it could adversely impact our provision for income taxes.

***We are exposed to fluctuations in currency exchange rates.***

Because we conduct a significant portion of our business outside the United States but report our results in U.S. dollars, we face exposure to adverse movements in currency exchange rates, which may cause our revenue and operating results to differ materially from expectations. In addition, fluctuation in our mix of U.S. and foreign currency denominated transactions may contribute to this effect as exchange rates vary. Moreover, as a result of these exchange rate fluctuations, revenue, cost of revenue, operating expenses and other operating results may differ materially from expectations when translated from the local currency into U.S. dollars upon consolidation. For example, if the U.S. dollar strengthens relative to foreign currencies our non-U.S. revenue would be adversely affected when translated into U.S. dollars. Conversely, a decline in the U.S. dollar relative to foreign currencies would increase our non-U.S. revenue when translated into U.S. dollars. Revenue in the three and nine months ended September 30, 2015 was negatively impacted by foreign currency translation of approximately $9.7 million and $28.4 million, respectively. Revenue in the three months ended September 30, 2014 was positively impacted by foreign currency translation of approximately $0.2 million, while revenue in the nine months ended September 30, 2014 was positively impacted by foreign currency translation of approximately $2.9 million. As exchange rates vary, revenue, cost of revenue, operating expenses and other operating results, when translated, may differ materially from expectations. In addition, our revenue and operating results are subject to fluctuation if our mix of U.S. and foreign currency denominated transactions and expenses changes in the future. In addition, we maintain intercompany loans and payables which are subject to translation losses due to foreign exchange fluctuation. We may enter into hedging arrangements in order to manage foreign currency exposure but such activity may not completely eliminate fluctuations in our operating results.

***Our business depends on retaining and attracting capable management and operating personnel.***

Our success depends in large part on our ability to attract and retain high-quality management and operating personnel, as well as skilled technical and marketing personnel, who are in high demand and are often subject to competing offers. Competition for qualified employees is intense in our industry, and the loss of even a few qualified employees, or an inability to attract, retain and motivate additional highly skilled employees required for the planned expansion of our business could harm our operating results and impair our ability to grow. To attract and retain key personnel, we use various measures, including an equity incentive program and incentive bonuses for executive officers and other key employees. However, some employees have been granted stock options with an exercise price that is or may become less than the market price, which reduces the incentive value of these grants. While we attempt to provide additional or different incentive compensation tools to mitigate this impact, the measures we employ to attract and maintain key personnel may not be effective enough to enable us to attract and retain the personnel we require to operate our business effectively.

***If we fail to protect confidential information against security breaches, or if property owners, managers or travelers are reluctant to use our online marketplace because of privacy or security concerns, we might face additional costs, and activity on our websites could decline.***

We collect and use personally identifiable information of property owners, managers and travelers in the operation of our business. Our systems may be vulnerable to computer viruses or physical or electronic break-ins that our security measures may not detect. Anyone that is able to circumvent our security measures could misappropriate confidential or proprietary information, cause interruption in our operations, damage our computers or those of our users, or otherwise damage our reputation and business. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. Security breaches of our systems, or even the systems of third parties we rely upon, such as credit card processors, could damage our reputation and expose us to litigation and possible liability under various laws and regulations. In addition, industry-wide incidents, or incidents specific to us, could deter people from using our online marketplace. Concern among property owners, managers and travelers regarding our use of personal information collected on our websites could keep them from using, or continuing to use, our online marketplace.

There are risks of security breaches both on and off our systems as we increase the types of technology we use to operate our marketplace, such as mobile applications. New and evolving technology systems and platforms may involve security risks that are difficult to predict and adequately guard against. In addition, third parties that process credit card transactions between us and property owners and managers maintain personal information collected from them. Such information could be stolen or misappropriated, and we could be subject to liability as a result. Further, property owners and managers may develop a lack of confidence in these third parties or in their ability to securely conduct credit card transactions on our websites or the Internet in general, which could adversely impact our business, revenue and operating results. Our property owners, managers and travelers may be harmed by such breaches and we may in turn be subject to costly litigation or regulatory compliance costs, and harm to our reputation and brand. Moreover, some property owners, managers and travelers may cease using our marketplace altogether.

The laws of some states and countries require businesses that maintain personal information about their residents in electronic databases to implement reasonable measures to keep that information secure. Our practice is to encrypt all sensitive information, but we do not know whether our current practice will be challenged under these laws. In addition, under certain of these laws, if there is a breach of our computer systems and we know or suspect that unencrypted personal data has been stolen, we are required to inform any user whose data was stolen, which could harm our reputation and business. Complying with the applicable notice requirements in the event of a security breach could result in significant costs. We may also be subject to contractual claims, investigation and penalties by regulatory authorities, and claims by persons whose information was disclosed.

Compounding these legal risks, many states and countries have enacted different and often contradictory requirements for protecting personal information collected and maintained electronically. Compliance with these numerous and contradictory requirements of is particularly difficult for us because we collect personal information from users in multiple jurisdictions. While we intend to comply fully with these laws, failure to comply could result in legal liability, cause us to suffer adverse publicity and lose business, traffic and revenue. If we were required to pay any significant amount of money in satisfaction of claims under these or similar laws, or if we were forced to cease our business operations for any length of time as a result of our inability to comply fully, our business, operating results and financial condition could be adversely affected.

In addition, third parties may target users of our websites directly with attempts to breach the security of their email accounts or management systems, such as through phishing attacks, which are fraudulent identity theft schemes designed to appear as legitimate emails from us or from our property owners and managers. Criminals may also employ other schemes aimed at defrauding our property owners, managers or travelers in ways that we may not anticipate or be able to adequately guard against. Although phishing attacks and other fraud schemes are generally not carried out through our systems, victims may nevertheless seek recovery from us. As a result, we may be required to defend ourselves in costly litigation and may suffer harm to our reputation, brand and business.

***If we are unable to adapt to changes in technology, our business could be harmed.***

Because property owners, managers and travelers can access our websites using a variety hardware and software platforms, we will need to continuously modify and enhance our service to keep pace with related technological changes. We may not be successful in developing necessary, functional and popular modifications and enhancements. Furthermore, uncertainties about the timing and nature of these necessary changes could result in unplanned research and development expenses. In addition, any failure of our online marketplace to operate effectively with future technologies could result in dissatisfaction from travelers, property owners, managers and advertisers, any of which could harm our business.

***We may be subject to liability for the activities of our property owners and managers, which could harm our reputation and increase our operating costs.***

We periodically receive complaints related to certain activities on our websites, including disputes over the authenticity of a vacation rental listing, unauthorized use of credit card and bank account information and identity theft, phishing attacks, potential breaches of system security, libel, and infringement of third-party copyrights, trademarks or other intellectual property rights. We have also experienced fraud by purported owners or managers listing properties which either do not exist or are significantly not as described in the listing. The methods used by perpetrators of fraud constantly evolve and are complex. Moreover, our trust and security measures may not detect all fraudulent activity. Consequently, we expect to continue to receive complaints from travelers and requests for reimbursement of their rental fees, as well as actual or threatened related legal action against us.

We may also be subject to claims of liability based on events that occur during travelers stays at vacation rentals, including those related to robbery, injury, death, and other similar incidents. As our websites become more integral to the rental transaction

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through our expanded e-commerce tools and offerings, the potential for these types of claims could increase. This in turn could increase our operating costs and adversely affect our business and results of operations, even if these claims do not result in liability, as we incur costs related to investigation and defense. The available terms and conditions of our websites specifically state that we are exempt from any liability to travelers relating to these matters. However, the enforceability of these terms varies from jurisdiction to jurisdiction, and the laws in this area are consistently evolving. If we are subject to liability or claims of liability relating to the acts of our property owners or managers, or due to fraudulent listings, we may be subject to negative publicity, incur additional expenses and be subject to liability, any of which could harm our business and our operating results.

***Loss or material modification of our credit card acceptance privileges could have a material adverse effect on our business and operating results. Credit card acceptance privileges involve additional potential costs relating to reimbursements and fraud.***

A significant percentage of our property owners and managers pay for their listings by credit card. The loss of our credit card acceptance privileges could significantly limit the availability and desirability of our products and services. Moreover, if we fail to fully perform our contractual obligations we could be obligated to reimburse credit card companies for refunded payments that have been contested by the cardholders. In addition, even when we are in compliance with these obligations, we bear other expenses including those related to the acceptance of fraudulent credit cards. As a result of all of these risks, credit card companies may require us to set aside additional cash reserves, may increase the transaction fees they charge us, or may even refuse to renew our acceptance privileges.

In addition, credit card networks, such as Visa, MasterCard and American Express, have adopted rules and regulations that apply to all merchants who process and accept credit cards and include the Payment Card Industry Data Security Standards, or the PCI DSS. Under these rules, we are required to adopt and implement internal controls over the use, storage and security of card data. We assess our compliance with the PCI DSS rules on a periodic basis and make necessary improvements to our internal controls. Failure to comply may subject us to fines, penalties, damages and civil liability and could prevent us from processing or accepting credit cards. However, we cannot guarantee that compliance with these rules will prevent illegal or improper use of our payments systems or the theft, loss or misuse of the credit card data.

The loss of, or the significant modification of, the terms under which we obtain credit card acceptance privileges could have a material adverse effect on our business, revenue and operating results.

***Our revenue, expenses and operating results could be affected by changes in travel, real estate and vacation rental markets, as well as general economic conditions.***

Our business is particularly sensitive to trends in the travel, real estate and vacation rental markets, which are unpredictable, as well as trends in the general economy. Therefore, our operating results, to the extent they reflect changes in the broader travel, real estate and vacation rental industries, may be subject to significant fluctuations.

For example, changes in the travel industry, such as disruptions caused by war, terrorist attacks, natural disasters, weather bankruptcies or diseases could significantly reduce the willingness of potential travelers to plan vacation and other travel. Such disruptions that harm or destroy vacation homes could cause the property owners and managers of such homes to cancel or fail to renew their listings. Downturns in real estate markets may result in decreased new building rates and increases in foreclosures, which could also result in fewer vacation rentals available for listing. Also, because vacation travel is generally dependent on discretionary spending, negative general economic conditions could significantly reduce the overall amount that travelers spend on vacation travel. Additionally, property owners may choose or be forced to sell their vacation rentals during periods of economic slowdown or recession. Any or all of these factors could reduce the demand for vacation rentals and our services, reducing our revenue. This in turn could increase our need to make significant expenditures to continue to attract property owners, managers and travelers to our websites.

***Vacation rentals are often located in popular vacation destinations around the world and utilized on a seasonal basis. Factors influencing the desirability of vacation rentals in a particular region or season could adversely affect our ability to obtain new listings and retain existing listings.***

Vacation rentals are often located in popular vacation destinations and utilized on a seasonal basis. As a result, our listings involve properties that are often concentrated in particular regions, and our revenue is dependent upon our ability or willingness to list properties in those regions. If we became unable or unwilling to list properties in a particular region, our listings in the region could decline or cease to grow, and revenue and results of operations could be adversely impacted.

In addition, factors influencing the desirability of vacation rentals in a particular region or during a specific season could adversely affect our ability to obtain new listings and retain existing listings. A significant natural disaster, political turmoil or other regional disturbance could reduce the number of available vacation rentals in that area, reducing our listing base and our revenue. In addition, if we do not have sufficient property listings in a newly popular vacation destination, we could fail to attract travelers to our websites and property owners and managers may opt to list their properties with a competitor having a greater presence in that area.

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***We could face liability for transactions and information on or accessible through our online marketplace.***

A significant portion of the information available through our online marketplace is submitted by property owners and managers and third parties. We also allow third parties to advertise their products and services on our websites and include links to third-party websites. We could be exposed to liability with respect to this third-party information. Property owners and managers could assert that information concerning them on our websites contains errors or omissions and third parties could seek damages from us for losses incurred if they rely upon such incorrect information. We could also be subject to claims that such information is defamatory, libelous, or infringes on third-party copyrights and privacy and publicity rights. We might be subject to claims that by providing links to third party websites, we are liable for wrongful actions by those third parties. Even if these claims do not result in liability to us, we could incur significant costs in investigating and defending against these claims.

In addition, our services feature a property review platform, which allows travelers to post property reviews and other information about properties, property owners and managers. Although this feedback is generated by users and not by us, claims of libel, defamation or other injury have been made against other Internet service providers offering similar forums and may be made against us for content posted in this forum. Our potential liability for this information could require us to expend substantial resources to reduce our liability exposure and may limit the attractiveness of our online marketplace. Moreover, our general liability insurance may not cover all potential claims to which we are exposed and may not be adequate to indemnify us for all liability that may be imposed.

***Property owner, manager or traveler complaints or negative publicity about our company, our services or our business activities could diminish use of our online marketplace.***

Property owner, manager or traveler complaints or negative publicity about our company, our services or our business activities could severely diminish consumer confidence in and use of our online marketplace. Our measures to combat risks of fraud and breaches of privacy and security can damage relations with our property owners and managers, for instance when we remove listings which have repeatedly been reported as misleadingly described. These measures heighten the need for prompt and accurate customer service to resolve irregularities and disputes. Effective customer service requires significant personnel expense, and this expense, if not managed properly, could significantly impact our profitability. Failure to manage or train our customer service representatives properly could compromise our ability to handle property owner, manager and traveler complaints effectively. If we do not handle these complaints effectively, our reputation may suffer, and we may lose the confidence of property owners, managers and travelers. We may also be the subject of blog or forum postings that include inaccurate statements and create negative publicity. As a result of these complaints or negative publicity, property owners and managers may discontinue their listing with us or travelers may discontinue their use of our websites, and our business and results of operations could be adversely impacted.

***If we do not adequately protect our intellectual property, our ability to compete could be impaired.***

Our intellectual property includes the content of our websites, our registered domain names, our registered and unregistered trademarks and patent applications. We believe that our intellectual property is an essential asset of our business and that our domain names and our technology infrastructure currently give us a competitive advantage in the online market for vacation rental listings. If we do not adequately protect our intellectual property, our brand, reputation and perceived content value could be harmed, resulting in an impaired ability to compete effectively.

To protect our intellectual property we rely on a combination of copyright, trademark, patent and trade secret laws, contractual provisions and our user policy and restrictions on disclosure. Upon discovery of potential infringement of our intellectual property, we promptly take action we deem appropriate to protect our rights. We regularly deliver cease and desist letters to parties who misappropriate our trademarks or content, such as aggregators of vacation rental listing content who use automated technology to download content from our online marketplace and display it on their websites without our permission. We also enter into confidentiality agreements with our employees and consultants and seek to control access to and distribution of our proprietary information in a commercially prudent manner. The efforts we have taken to protect our intellectual property may not be sufficient or effective, and, despite these precautions, it may be possible for other parties to copy or otherwise obtain and use the content of our websites without authorization. We may be unable to prevent competitors from acquiring domain names or trademarks that are similar to, infringe upon or diminish the value of our domain names, service marks and our other proprietary rights. Even if we do detect violations and decide to enforce our intellectual property rights, litigation may be necessary to enforce our rights, and any enforcement efforts we undertake could be time-consuming, expensive, distracting and result in unfavorable outcomes. A failure to protect our intellectual property in a cost-effective and meaningful manner could have a material adverse effect on our ability to compete.

As of September 30, 2015, we had 22 patent applications and no issued patents. Any future patents issued to us may be challenged, invalidated or circumvented, may not provide sufficiently broad protection or may not prove to be enforceable in actions against alleged infringers. Furthermore, effective patent, trademark, copyright and trade secret protection may not be available in every country in which our products are available over the Internet. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain and still evolving.

***We may be subject to claims that we violated intellectual property rights of others, which are extremely costly to defend and could require us to pay significant damages and limit our ability to operate.***

Companies in the Internet and technology industries, and other patent and trademark holders seeking to profit from royalties in connection with grants of licenses, own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. We have received and may continue to receive claims that we have violated other parties intellectual property rights. There may be intellectual property rights held by others, including issued or pending patents and trademarks, that cover significant aspects of our technologies, content, branding or business methods. Any intellectual property claim against us, regardless of merit, could be time-consuming and expensive to settle or litigate and could divert our management s attention and other resources. These claims also could subject us to significant liability for damages and could result in our having to stop using technology, content, branding or business methods found to be in violation of another party s rights. We might be required or may opt to seek a license for rights to intellectual property held by others, which may not be available on commercially reasonable terms, or at all. If we cannot license or develop technology, content, branding or business methods for any allegedly infringing aspect of our business, we may be unable to compete effectively. Even if a license is available, we could be required to pay significant royalties, which could increase our operating expenses. We may also be required to develop alternative non-infringing technology, content, branding or business methods, which could require significant effort and expense and be inferior. Any of these results could harm our operating results.

***We currently rely on a small number of third-party service providers to host and deliver a significant portion of our services, and any interruptions or delays in services from these third parties could impair the delivery of our services and harm our business.***

We rely on third-party service providers for numerous products and services, including payment processing services, data center services, web hosting services, insurance products for customers and travelers and some customer service functions. We rely on these companies to provide uninterrupted services and to provide their services in accordance with all applicable laws, rules and regulations.

We use a combination of third-party data centers distributed globally across multiple regions to host our websites and core services. We do not control the operation of any of the third-party data center facilities we use. These facilities, including our co-location hosting center, may be subject to break-ins, computer viruses, denial-of-service attacks, sabotage, acts of vandalism and other misconduct. They are also vulnerable to damage or interruption from power loss, telecommunications failures, fires, floods, earthquakes, hurricanes, tornadoes and similar events. We currently do not have a comprehensive disaster recovery plan in place nor do our systems provide complete redundancy of data storage or processing. As a result, the occurrence of any of these events, a decision by our third-party service providers to close their data center facilities without adequate notice or other unanticipated problems could result in loss of data as well as a significant interruption in our services and harm to our reputation and brand. Additionally, our third-party data center facility agreements are of limited durations, and our third-party data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew our agreements with these facilities on commercially reasonable terms, we may experience delays in the provisioning of our services until an agreement with another data center facility can be arranged. This shift to alternate data centers could take more than 24 hours depending on the nature of the event.

Furthermore, we depend on continuous and uninterrupted access to the Internet through third-party bandwidth providers to operate our business. If we lose the services of one or more of our bandwidth providers for any reason or if their services are disrupted, we could experience disruption in our services or we could be required to retain the services of a replacement bandwidth provider, which could harm our business and reputation.

Our operations are dependent on the availability of electricity, which also comes from third-party providers. If we or the third-party data center facilities that we use to deliver our services were to experience a major power outage, it could result in disruption of our services and harm to our business.

If these companies experience difficulties and are not able to provide services in a reliable and secure manner, if they do not operate in compliance with applicable laws, rules and regulations and, with respect to payment and card processing companies, if they are unable to effectively combat the use of fraudulent payments on our websites, our results of operations and financial positions could be materially and adversely affected. In addition, if such third-party service providers were to cease operations or face other business disruption either temporarily or permanently, or otherwise face serious performance problems, we could suffer increased costs and delays until we found or developed an equivalent replacement, any of which could have an adverse impact on our business and financial performance.

***If we do not successfully implement any acquisition strategies, our operating results and prospects could be harmed.***

We face competition within our industry for acquisitions of businesses, technologies and assets, and, in the future, such competition may become more intense. As such, even if we are able to identify an acquisition that we would like to consummate, we may not be able to complete the acquisition on commercially reasonable terms or at all because of such competition. Furthermore, if we enter into negotiations that are not ultimately consummated, those negotiations could result in diversion of management time and significant out-of-pocket costs. Even if we are able to complete such acquisitions, we may additionally expend significant amounts of cash or incur substantial debt to finance them, which indebtedness could result in restrictions on our business and use of available cash. In addition, we may finance or otherwise complete acquisitions by issuing equity or convertible debt securities, which could result in dilution of our existing stockholders. If we fail to evaluate and execute acquisitions successfully, we may not be able to realize their benefits. If we are unable to successfully address any of these risks, our business, financial condition or operating results could be harmed.

***We rely on assumptions and estimates and data from third parties to calculate certain of our key metrics, and real or perceived inaccuracies in such metrics may harm our reputation and negatively affect our business.***

Certain key metrics, such as number of unique visitors, total traffic and number of listings, reviews and opinions, are calculated, in some cases, using internal company data and, in other cases, relying on data from third parties. While these numbers are based on what we believe to be reasonable calculations for the applicable periods of measurement, there are inherent challenges in measuring usage and user engagement across our large user base around the world. Accordingly, the calculations of our unique visitors may not accurately reflect the number of people actually using our platforms. In addition, our measures of growth may differ from estimates published by third parties or from similar metrics of our competitors due to differences in methodologies utilized by us and the third parties on which we rely for this data.

We are continually seeking to improve our ability to estimate these key metrics. We regularly review and adjust our processes for calculating our internal metrics to improve their accuracy. If our users, advertisers, partners and stockholders do not perceive our metrics to be accurate representations or if we discover material inaccuracies in our user metrics, our reputation may be harmed. This in turn could cause property owners, managers, travelers and advertisers not to use our products and services which could negatively affect our business and operating results.

***Our culture emphasizes rapid innovation and prioritizes property owner, manager, and traveler experience over short-term financial results.***

We have a culture that encourages rapid development and release of new and improved products, and generally prioritizes property owner, manager, and traveler experience over short-term financial results. We have taken actions in the past and may continue to make product or other decisions going forward that have the effect of reducing our short-term revenue or profitability if we believe that the decisions benefit long term-revenue and profitability through improved property owner, manager, and traveler experience and/or conversion rates and pricing and fees. The short-term reductions in revenue or profitability could be more severe than we anticipate. These decisions may not produce the long-term benefits that we expect, in which case our growth, website experience, relationships with property owners, managers, and travelers and advertisers, and business and results of operations could be harmed.

***Our failure to maintain effective internal controls could adversely affect our financial position and lower our stock price.***

We are subject to reporting and other obligations under the Securities Exchange Act of 1934, including the requirements of Sarbanes-Oxley. These provisions require annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent registered public accounting firm addressing our assessments. We also operate in a complex environment and expect these obligations, together with our rapid growth and expansion through acquisitions, to place significant demands on our management and administrative resources, including accounting and tax resources. Although we have expanded the size and depth of the finance and accounting staff in our U.S. and European headquarters, we may need to hire additional personnel. If we are unable to conclude that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to attest that our management s report is fairly stated or they are unable to express an opinion on our management s assessment or on the effectiveness of our internal control over financial reporting, our investors could lose confidence in the accuracy and completeness of our financial reports.

***We might require additional capital to support business growth, and this capital might not be available.***

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new products or services or enhance our existing products or services, enhance our operating infrastructure and acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings to secure additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

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***We have significant indebtedness, which could adversely affect our business and financial condition.***

As of September 30, 2015, the aggregate face value of our outstanding convertible senior promissory notes was $402.5 million. Risks relating to our indebtedness include:

- increasing our vulnerability to general adverse economic and industry conditions;
- requiring us to dedicate a portion of our cash flow from operations to principal and interest payments on our indebtedness, thereby reducing the availability of cash flow to fund working capital, capital expenditures, acquisitions and investments and other general corporate purposes;
- making it more difficult for us to optimally capitalize and manage the cash flow for our businesses;
- limiting our flexibility in planning for, or reacting to, changes in our businesses and the markets in which we operate;
- possibly placing us at a competitive disadvantage compared to our competitors that have less debt;
- applying the accounting method for convertible debt securities that may be settled in cash, which requires the notes equity component to be included in the paid-in capital section of stockholders equity and the value of the equity component to be treated as a debt discount. The amortization of this discount will result in lower reported net income which in turn could adversely affect our reported financial results;
- limiting our ability to borrow additional funds or to borrow funds at rates or on other terms that we finds acceptable; and
- responding to the conditional conversion feature of the notes, which if triggered could adversely affect our liquidity if we elect to satisfy our conversion obligation through the payment of cash.

**Risks Related to the Ownership of our Common Stock**

***Our stock price may be volatile.***

The market price of our common stock is likely to be volatile and could be subject to wide fluctuations in response to, among other things, the risk factors described in this section of this Quarterly Report on Form 10-Q, and other factors beyond our control. Factors affecting the trading price of our common stock could include:

- variations in our operating results;
- variations in operating results of similar companies and competitors;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- changes in our outlook for future operating results which are communicated to investors and analysts;
- announcements of technological innovations, new products, services or service enhancements, strategic alliances or agreements by us or by our competitors;
- marketing and advertising initiatives by us or our competitors;
- the gain or loss of listings;
- threatened or actual litigation;
- changes in our management;
- recruitment or departures of key personnel;
- market conditions in our industry, the travel industry and the economy as a whole;
- the overall performance of the equity markets;
- sales or purchases of shares of our common stock by existing stockholders;
- the reports of industry research analysts who cover our competitors and us;
- stock-based compensation expense under applicable accounting standards; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations and general economic, political and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock regardless of our actual operating performance. Each of these factors, among others, could harm the value of our common stock.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us, regardless of the merits or outcome, could result in substantial costs and divert our management s attention from other business concerns, which could materially harm our business.

***If securities analysts and other industry experts do not continue to publish research or publish negative research about our business, our stock price and trading volume could decline.***

The trading market for our common stock depends in part on the research, reports and other media that securities analysts and other industry experts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes negative research about our business, our stock price could decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, we could lose visibility in the stock market and demand for our stock could decrease, which could cause our stock price or trading volume to decline. If one or more industry analysts publish negative statements about our business, our stock price could decline.

***We do not anticipate paying any dividends on our common stock.***

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. If we do not pay cash dividends, our stockholders could receive a return on their investment in our common stock only if the market price of our common stock has increased when they sell their shares.

***Our charter documents, Delaware law, and the indenture governing our outstanding convertible senior promissory notes could prevent a takeover that stockholders consider favorable and could also depress the market price of our stock.***

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

- creating a classified board of directors whose members serve staggered three-year terms;
- not providing for cumulative voting in the election of directors;
- authorizing our board of directors to issue, without stockholder approval, preferred stock with rights senior to those of our common stock;
- prohibiting stockholder action by written consent; and
- requiring advance notification of stockholder nominations and proposals.

Similarly, the indenture governing our outstanding convertible promissory notes includes provisions that:

- prohibit us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the promissory notes; and

- may require us under certain circumstances to repurchase all or a portion of these promissory notes, and in some cases repurchase the promissory notes subject to an additional make whole adjustment.

Certain provisions under Delaware law, the provisions listed above, and other provisions included in our amended and restated certificate of incorporation and our amended and restated bylaws could discourage potential takeover attempts, reduce the price that investors might be willing to pay in the future for shares of our common stock and result in the market price of our common stock being lower than it would be without these provisions.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

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### Item 5. Other Information

Not applicable.

### Item 6. Exhibits

See the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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**HomeAway, Inc.**

**SIGNATURE**

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.

**HOMEAWAY, INC.**

Dated: November 6, 2015

By: /s/ Lynn Atchison
Lynn Atchison
*Chief Financial Officer and Secretary*

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## EXHIBIT INDEX

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Exhibit | Filing Date |
|---|---|---|---|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation, as currently in effect. | S-1 | 333-172783 | 3.2 | March 11, 2011 |
| 3.2 | Amended and Restated Bylaws, as currently in effect. | S-1 | 333-172783 | 3.4 | March 11, 2011 |
| 10.1* | Executive Employment Agreement between the Registrant and Melissa Fruge dated October 1, 2015 | | | | |
| 31.1* | Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | |
| 31.2* | Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | |
| 32.1** | Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | |
| 32.2** | Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | |
| 101.INS* | XBRL Instance Document | | | | |
| 101.SCH* | XBRL Taxonomy Extension Schema Document | | | | |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document | | | | |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document | | | | |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document | | | | |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document | | | | |

* Filed herewith.
** Furnished herewith.