

KEMET CORP  
Form 10-Q  
August 10, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2009

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

Commission File Number: 0-20289

**KEMET CORPORATION**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**57-0923789**

(I.R.S. Employer Identification No.)

**2835 KEMET WAY, SIMPSONVILLE, SOUTH CAROLINA 29681**

(Address of principal executive offices, zip code)

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(864) 963-6300

(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: **N/A**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of August 7, 2009 was 80,867,509.

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**KEMET CORPORATION AND SUBSIDIARIES**

**Form 10-Q for the Quarter Ended June 30, 2009**

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**Condensed Consolidated Balance Sheets**

(Amounts in thousands, except per share data)

(Unaudited)

	June 30, 2009	March 31, 2009 (As Adjusted- Note 2)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 34,135	\$ 39,204
Accounts receivable, net	123,976	120,139
Inventories	150,807	154,981
Prepaid expenses and other current assets	14,809	11,245
Deferred income taxes	1,850	151
Total current assets	325,577	325,720
Property and equipment, net of accumulated depreciation of \$647,115 and \$622,972 as of June 30, 2009 and March 31, 2009, respectively	356,911	357,977
Intangible assets, net	24,418	24,094
Other assets	16,197	6,360
Total assets	\$ 723,103	\$ 714,151
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 19,879	\$ 25,994
Accounts payable, trade	51,299	52,332
Accrued expenses	52,587	51,125
Income taxes payable	954	1,127
Total current liabilities	124,719	130,578
Long-term debt, less current portion	222,502	280,752
Warrant liability	31,400	
Other non-current obligations	65,539	57,316
Deferred income taxes	7,151	5,466
Stockholders' equity:		
Common stock, par value \$0.01, authorized 300,000 shares, issued 88,525 and 88,525 shares at June 30, 2009 and March 31, 2009, respectively	885	885
Additional paid-in capital	367,064	367,257
Retained deficit	(56,252)	(81,342)
Accumulated other comprehensive income	19,084	12,663
Treasury stock, at cost (7,658 and 7,714 shares at June 30, 2009 and March 31, 2009, respectively)	(58,989)	(59,424)
Total stockholders' equity	271,792	240,039
Total liabilities and stockholders' equity	\$ 723,103	\$ 714,151

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**KEMET CORPORATION AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**

(Amounts in thousands, except per share data)

(Unaudited)

	<b>Quarters Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
		<b>(As Adjusted- Note 2)</b>
Net sales	\$ 150,167	\$ 242,844
Operating costs and expenses:		
Cost of sales	129,806	225,788
Selling, general and administrative expenses	18,083	28,219
Research and development	4,779	10,096
Restructuring charges		6,797
Goodwill impairment		88,647
Write down of long-lived assets		63,928
Total operating costs and expenses	152,668	423,475
Operating loss	(2,501)	(180,631)
Other expense (income):		
Interest income	(31)	(238)
Interest and amortization of debt discount and expense	5,819	7,729
Gain on early extinguishment of debt	(38,921)	
Other expense (income), net	4,512	1,333
Income (loss) before income taxes	26,120	(189,455)
Income tax expense (benefit)	1,030	(80)
Net income (loss)	\$ 25,090	\$ (189,375)
Net income (loss) per share:		
Basic	\$ 0.31	\$ (2.36)
Diluted	\$ 0.31	\$ (2.36)

See accompanying notes to the unaudited condensed consolidated financial statements.

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**KEMET CORPORATION AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows**

(Amounts in thousands)

(Unaudited)

	<b>Quarters Ended June 30,</b>	
	<b>2008</b>	
	<b>(As Adjusted-</b>	
	<b>Note 2)</b>	
	<b>2009</b>	
Sources (uses) of cash and cash equivalents		
Operating activities:		
Net income (loss)	\$ 25,090	\$ (189,375)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Gain on early extinguishment of debt	(38,921)	
Depreciation and amortization	14,766	18,114
Goodwill impairment		88,647
Write down of long-lived assets		63,928
Stock-based compensation expense	241	539
Change in deferred income taxes	(390)	558
Change in operating assets	4,523	7,808
Change in operating liabilities	(1,946)	(5,898)
Other	612	207
Net cash provided by (used in) operating activities	3,975	(15,472)
Investing activities:		
Capital expenditures	(1,387)	(11,209)
Acquisitions, net of cash received		(1,000)
Net cash used in investing activities	(1,387)	(12,209)
Financing activities:		
Proceeds from issuance of debt	49,818	4,311
Payments of long-term debt	(49,832)	(22,390)
Debt extinguishment and issuance costs	(7,811)	
Proceeds from sale of common stock to employee savings plan		85
Net cash used in financing activities	(7,825)	(17,994)
Net decrease in cash and cash equivalents	(5,237)	(45,675)
Effect of foreign currency fluctuations on cash	168	(207)
Cash and cash equivalents at beginning of fiscal period	39,204	81,383
Cash and cash equivalents at end of fiscal period	\$ 34,135	\$ 35,501

See accompanying notes to the unaudited condensed consolidated financial statements.

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**Note 1. Basis of Financial Statement Presentation**

The condensed consolidated financial statements contained herein are unaudited and have been prepared from the books and records of KEMET Corporation and its subsidiaries ( KEMET or the Company ). In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, and therefore, do not include all information and footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles. Although the Company believes that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and notes thereto included in the Company's fiscal year ended March 31, 2009, Form 10-K ( Company's 2009 Annual Report ). Net sales and operating results for the quarter ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. In consolidation, all significant intercompany amounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation. In addition, as noted in Note 2, Debt, Liquidity and Capital Resources, certain prior period amounts have been adjusted to conform to Financial Accounting Standards Board ( FASB ) Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* ( FSP No. APB 14-1 ).

The significant accounting policies followed by the Company are presented on pages 85-94 of the Company's 2009 Annual Report.

**Recently Issued Accounting Pronouncements**

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ( SFAS No. 165 ). SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS No. 165 sets forth the period after the balance sheet date during which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date, and the disclosures that should be made about such events or transactions. SFAS No. 165 is effective for reporting periods ending after June 15, 2009, and did not result in significant changes in subsequent events that an entity reports, either through recognition or disclosure, in its financial statements. This statement introduces the concept of financial statements being available to be issued, and requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued.

In April 2009, the FASB approved FSP No. 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP No. 107-1 and APB 28-1 ), which increases the frequency of fair value disclosures to a quarterly instead of an annual basis. FSP No. 107-1 and APB 28-1 are effective for interim and annual periods ending after June 15, 2009 or the first quarter of fiscal year 2010 for the Company. The adoption of this accounting guideline did not impact the Company's results of operations or financial position.

In April 2009, the FASB approved FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP No. 157-4 ), which provides guidelines for a broad interpretation of when to apply market-based fair value measurements. The FSP reaffirms management's need to use judgment to determine when a market that was once active has become inactive and in determining fair values in markets that are no longer active. FSP No. 157-4 is effective for interim and annual periods ending after June 15, 2009 or the first quarter of fiscal year 2010 for the Company and shall be applied prospectively. The adoption of FSP No. 157-4 did not have a material impact on the Company's results of operations or financial position.



On December 30, 2008, the FASB issued FSP FAS 132 (R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*. This FSP requires additional disclosures about plan assets for sponsors of defined benefit pension and postretirement plans including expanded information regarding investment strategies, major categories of plan assets, and concentrations of risk within plan assets. Additionally, this FSP requires disclosures similar to those required under SFAS No. 157 with respect to the fair value of plan assets such as the inputs and valuation techniques used to measure fair value and information with respect to classification of plan assets in terms of the hierarchy of the source of information used to determine their value. The disclosures under this FSP are required for annual periods ending after December 15, 2009, or fiscal year 2010 for the Company. The Company is currently evaluating the requirements of these additional disclosures.

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On May 9, 2008, the FASB issued FSP No. APB 14-1 which requires issuers of convertible debt that may be settled wholly or partly in cash when converted to account for the debt and equity components separately. FSP No. APB 14-1 is effective for fiscal years beginning after December 15, 2008, or fiscal year 2010 for the Company, and must be applied retrospectively to all periods presented. See Note 2, Debt, Liquidity and Capital Resources, for discussion of the impact of the Company's adoption of FSP No. APB 14-1 as of April 1, 2009 and the retrospective adjustment of previously reported amounts.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*, (FSP FAS 142-3). FSP FAS 142-3 amends the list of factors an entity should consider in developing renewal or extension assumptions when determining the useful life of recognized intangible assets under FASB No. 142, *Goodwill and Other Intangible Assets*, (SFAS No. 142). FSP FAS 142-3 applies to (i) intangible assets that are acquired individually or with a group of other assets and (ii) intangible assets acquired in both business combinations and asset acquisitions. FSP FAS 142-3 removes the requirement in SFAS No. 142 for an entity to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity consider its own experience in renewing similar arrangements. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and must be applied prospectively only to intangible assets acquired after the FSP's effective date. The adoption of FSP FAS 142-3 has not impacted the Company's consolidated financial statements for prior periods, however, the Company's consolidated financial statements may be impacted to the extent the Company acquires intangible assets in the future.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, which requires additional disclosures about an entity's strategies and objectives for using derivative instruments, the location and amounts of derivative instruments in an entity's financial statements, how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. Certain disclosures are also required with respect to derivative features that are credit-risk-related. SFAS No. 161 was effective for the Company beginning April 1, 2009 on a prospective basis. See Note 1, Warrant Liability for the additional disclosures required by this standard.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) establishes principles and requirements for how the acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date fair value. It further requires that acquisition related costs be recognized separately from the acquisition and expensed as incurred; that restructuring costs generally be expensed in periods subsequent to the acquisition date; and that changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recognized as a component of the provision for taxes. SFAS No. 141(R) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2008.

In September 2007, the FASB issued Emerging Issues Task Force (EITF) No. 07-05, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock*. This EITF consensus addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of SFAS No. 133. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under paragraphs 6-9 of SFAS No. 133 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). See Note 2, Debt, Liquidity and Capital Resources, for discussion of the impact of the Company's adoption of FSP No. APB 14-1 and EITF No. 07-05 as of April 1, 2009 and the retrospective adjustment of previously reported amounts.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option were elected to be reported in earnings. SFAS No. 159 was effective for the Company beginning in the first quarter of fiscal year 2009. The Company did not elect the fair value option under SFAS No. 159 for any financial assets and liabilities as of April 1, 2008.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, provides guidance for measuring fair value and requires additional disclosures. This statement does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. The effective date of the provisions of SFAS No. 157 for non-financial assets and liabilities, except for items recognized at fair value on a recurring basis, was deferred by FASB Staff Position ( FSP ) No. 157-2. SFAS No. 157 for non-financial assets and liabilities is now effective for fiscal years beginning after November 15, 2008. The adoption

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of SFAS No. 157 for financial and non-financial assets and liabilities did not have a material impact on the Company's financial position or results of operations.

*Warrant Liability*

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, depending on the terms of the specific warrant agreement. The Closing Warrants issued to K Financing (as hereinafter defined) under the Platinum Credit Facility (as hereinafter defined) were reviewed to determine whether they meet the definition of a derivative under SFAS No. 133. The Company's evaluation of the Closing Warrants concluded that they did not qualify for a scope exception under SFAS No. 133 as they were determined to not be indexed to the Company's stock as prescribed by EITF No. 07-05 since the strike price is not fixed. The Closing Warrants have been recorded in the line item **Warrant liability** on the Condensed Consolidated Balance Sheets as of June 30, 2009 at their estimated fair value of \$31.4 million. All future changes in the fair value of these warrants will be recognized in earnings until the Closing Warrants are exercised, expire, or in the event that the exercise price becomes fixed. The Company estimates the fair value of these warrants using the Black-Scholes option pricing model using the following assumptions:

	June 30, 2009
Expected life	10 years
Expected volatility	74.1%
Risk-free interest rate	3.6%
Dividends	0%

The Closing Warrant is exercisable at a purchase price of \$0.50 per share, subject to an adjustment which reduces the exercise price to a floor of \$0.35 based on a sliding scale once the aggregate borrowings under the Platinum Line of Credit Loan and the Platinum Working Capital Loan exceed \$12.5 million at any time prior to the tenth anniversary of the Closing Warrant's date of issuance. The floor exercise price would be reached once the aggregate borrowings under the Platinum Line of Credit Loan and the Platinum Working Capital Loan reach \$20.0 million. If the strike price becomes fixed in the future it will result in the reclassification of the warrant liability's then fair value into the line item

Additional paid-in capital on the Condensed Consolidated Balance Sheets and it will no longer be considered a freestanding liability derivative that is marked to market on a quarterly basis.

### ***Fair Value Measurement***

The Company adopted SFAS No. 157 (as amended by associated FSP's), prospectively effective April 1, 2008, with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company's consolidated financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. The Company adopted the remaining aspects of SFAS No. 157 relative to nonfinancial assets and liabilities that are measured at fair value, but are recognized and disclosed at fair value on a nonrecurring basis, prospectively effective April 1, 2009.

SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.



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The adoption of this statement did not have a material impact on the Company's consolidated results of operations and financial condition.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 are as follows (amounts in thousands):

	Level 1	Fair value measurement using		Level 3	Fair Value June 30, 2009
		Level 2			
<b>Assets:</b>					
Money markets (1)	\$	10,653	\$	\$	10,653
<b>Liabilities:</b>					
Warrant liability		31,400		\$	31,400
	\$	10,653	\$	\$	42,053

(1) Included in the line item "Cash and cash equivalents" on the Condensed Consolidated Balance Sheets.

**Revenue Recognition**

The Company recognizes revenue only when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the seller's price to the buyer is fixed or determinable, and (4) collectibility is reasonably assured.

A portion of sales is related to products designed to meet customer specific requirements. These products typically have stricter tolerances making them useful to the specific customer requesting the product and to customers with similar or less stringent requirements. Products with customer specific requirements are tested and approved by the customer before the Company mass produces and ships the product. The Company recognizes revenue at shipment as the sales terms for products produced with customer specific requirements do not contain a final customer acceptance provision or other provisions that are unique and would otherwise allow the customer different acceptance rights.

A portion of sales is made to distributors under agreements allowing certain rights of return and price protection on unsold merchandise held by distributors. The Company's distributor policy includes inventory price protection and "ship-from-stock and debit" (SFSD) programs common in the industry.

The SFSD program provides a mechanism for the distributor to meet a competitive price after obtaining authorization from the Company's local sales office. This program allows the distributor to ship its higher-priced inventory and debit the Company for the difference between KEMET's list price and the lower authorized price for that specific transaction. Management analyzes historical SFSD activity to determine the SFSD exposure on the global distributor inventory at the balance sheet date. The establishment of these reserves is recognized as a component of the line item "Net sales" on the Condensed Consolidated Statements of Operations, while the associated reserves are included in the line item "Accounts receivable, net" on the Condensed Consolidated Balance Sheets.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, depending on the terms of the warrants.

The Company provides a limited warranty to customers that the Company's products meet certain specifications. The warranty period is generally limited to one year, and the Company's liability under the warranty is generally limited to a replacement of the product or refund of the purchase price of the product. Warranty costs as a percentage of net sales were less than 1% for the quarters ended June 30, 2009 and 2008. The Company recognizes warranty costs when both probable and reasonably estimable.

*Use of Estimates and Assumptions*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates, assumptions, and judgments. Estimates and assumptions are based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

The Company's judgments are based on management's assessment as to the effect certain estimates, assumptions, or future



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trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

***Inventories***

Inventories are stated at the lower of cost or market. The components of inventories are as follows (amounts in thousands):

	June 30, 2009	March 31, 2009
<b>Inventories:</b>		
Raw materials and supplies	\$ 59,038	\$ 59,687
Work in process	52,089	48,105
Finished goods	39,680	47,189
	\$ 150,807	\$ 154,981

**Note 2. Debt, Liquidity and Capital Resources**

The condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Specifically, the condensed consolidated financial statements do not include any adjustments relating to the recoverability or classification of recorded assets, or the amounts or classification of liabilities that might be necessary in the event the Company is unable to continue as a going concern. The uncertainties surrounding the Company's liquidity and capital resources and ability to meet financial covenants cast doubt on the Company's ability to continue as a going concern. The failure to successfully maintain sufficient cash and/or the non-compliance with the Company's financial covenants without a waiver or amendment granted by the Company's lenders would have a material adverse effect on the Company's business, results of operations, financial position and liquidity.

The global economic downturn had an adverse impact on the Company's results of operations and liquidity for the past several quarters. Throughout fiscal year 2009, the Company took aggressive steps to offset the adverse impact of the economic downturn on its operations. These steps included cost reduction programs, working capital initiatives and selling non-core assets. In the first quarter of fiscal year 2010, the Company took further steps to address its debt position and liquidity outlook by executing a credit facility with K Financing, LLC ( "K Financing"), an affiliate of Platinum Equity Capital Partners II, L.P. (the "Platinum Credit Facility"), consummating a tender offer for 53.7% of its 2.25% Convertible Senior Notes (the "Notes") and amending its credit facilities with UniCredit Corporate Banking S.p.A. ( "UniCredit").

Given the Company's cost reduction and working capital initiatives, the Company's anticipated borrowing ability under the working capital loan provision of the Revised Amended and Restated Platinum Credit Facility with K Financing (the "Revised Amended and Restated Platinum Credit Facility") and amendments the Company entered into with UniCredit, the Company estimates its current operating plans will provide for sufficient cash to cover liquidity requirements during fiscal year 2010. The Company currently anticipates that it will continue to experience severe pressure on its liquidity during fiscal year 2010; however, the Company expects to generate sufficient cash from operations to satisfy its liquidity requirements. Furthermore, the generation of adequate liquidity will largely depend upon the Company's ability to achieve sales growth over the next several quarters and its ability to execute its current operating plans and to manage costs. In light of the improvement the Company experienced in sales volume in the first quarter of fiscal year 2010, the improvement the Company experienced in its operating results as it began to fully benefit from its cost reduction plans, and the continued control it exhibits over its working capital levels, the Company believes it will be

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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successful in generating adequate liquidity. Net sales for the first quarter of fiscal year 2010 improved by 10.4% when compared to the fourth quarter of fiscal year 2009.

Given the degree of uncertainty with respect to the near-term outlook for the global economy and other risks and uncertainties, there can be no assurance that we will be successful in generating adequate liquidity. An unanticipated decrease in sales, sales that fall below the Company's expectations, or other factors that would cause the actual outcome of the Company's plans to differ from expectations could create a shortfall in cash available to fund the Company's liquidity needs. The Company will continually monitor and adjust its business plan as necessary to respond to developments in the Company's business, markets and the broader economy. In addition to the actions discussed below, the Company continues to review additional initiatives to improve liquidity in the short-term as well as to reduce the Company's total overall leverage, including the sale of non-core assets.

Based on the Company's first quarter results, which exceeded its forecasted operating plans, and the Company's operating plans for the balance of fiscal year 2010, the Company currently believes that it will meet the financial covenants required by the Revised Amended and Restated Platinum Credit Facility and the credit facilities with UniCredit (under its credit facility with an original principal balance of EUR 60 million ( " Facility A " )), at each of the measurement dates during fiscal year 2010. The

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Company's forecast anticipates a steady recovery, over the next several quarters, of the principal markets and industries into which its products are sold. The Company's expectations in this regard are based on various information sources including, among others, industry surveys and input from various key customers. Given the degree of uncertainty with respect to the near-term outlook for the global economy and the possible effects on the Company's operations, there is significant uncertainty as to whether the Company's forecasts will be achieved. There can be no assurance that the Company will achieve its forecasted operating profit for the balance of the year or that the Company will be able to meet the financial covenants required by the Revised Amended and Restated Platinum Credit Facility and the UniCredit facilities. In the event of a covenant breach, the Company would seek a waiver or amendment, but such remedy would be out of its control and at the discretion of its lenders.

The Company's liquidity needs arise from working capital requirements, capital expenditures, principal and interest payments on debt, and costs associated with the implementation of the restructuring plan. Historically, these cash needs have been met by cash flows from operations, borrowings under credit agreements and existing cash balances.

A summary of debt is as follows (amounts in thousands):

	June 30, 2009	March 31, 2009 (As Adjusted)
<b>Debt</b>		
Convertible Debt	\$ 69,934	\$ 148,641
UniCredit Agreement-A	76,608	79,848
UniCredit Agreement-B	49,469	46,578
Platinum Term Loan	12,040	
Platinum Line of Credit	4,391	
Vishay	15,000	15,000
Other	14,939	16,679
<b>Total debt</b>	<b>242,381</b>	<b>306,746</b>
Current maturities	(19,879)	(25,994)
<b>Total long-term debt</b>	<b>\$ 222,502</b>	<b>\$ 280,752</b>

***Platinum Credit Facility and Tender Offer***

On May 5, 2009, the Company announced the execution of the Platinum Credit Facility. The Platinum Credit Facility as announced consisted of a term loan of up to \$52.5 million (Platinum Term Loan), a line of credit loan (Platinum Line of Credit Loan) that may be borrowed from time to time (but not reborrowed after being repaid) of up to \$12.5 million and a working capital loan (Platinum Working Capital Loan) of up to \$12.5 million.

Concurrently, on May 5, 2009, the Company commenced a tender offer for any and all of the Notes. The Platinum Term Loan discussed above could only be used to purchase the Notes and was to be funded only to the extent required to purchase Notes accepted for purchase pursuant to the tender offer. Additionally, funds from the Platinum Line of Credit Loan and Platinum Working Capital Loan under the Platinum Credit Facility are available to the Company, for limited purposes, subject to the satisfaction or waiver of certain conditions, including the consummation of the tender offer on the terms described in the Offer to Purchase. Under the initial terms of the tender offer, holders of Notes who validly tendered, and did not validly withdraw, their Notes on or prior to the Expiration Date would receive \$300 for each \$1,000 principal amount of Notes purchased in the tender offer, plus accrued and unpaid interest to, but not including, the date of payment for the Notes accepted

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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for payment. The tender offer and KEMET's obligation to purchase and pay for the Notes validly tendered and not validly withdrawn pursuant to the tender offer was initially conditioned upon (1) at least \$166.3 million in aggregate principal amount of Notes (representing 95% of the outstanding Notes) being validly tendered and not validly withdrawn, and (2) the receipt by KEMET of the proceeds from the Platinum Term Loan of up to \$52.5 million from K Financing.

On June 3, 2009, the Company announced the extension of the tender offer until the expiration date of June 12, 2009. All terms and conditions of the tender offer remained unchanged with this extension. On June 8, 2009, the Company announced an increase in the purchase price from \$300 per \$1,000 principal amount of the Notes to \$400 per \$1,000 principal amount of the Notes and extended the expiration date to June 19, 2009. In addition, the Company decreased the minimum tender condition from \$166.3 million in aggregate principal amount of the Notes (representing 95% of the outstanding Notes) to \$122.5 million in aggregate principal amount of the Notes (representing 70% of the outstanding Notes). The Company also executed the Amended and Restated Credit Agreement with K Financing (as amended, the Amended and Restated Platinum Credit Facility), whereby, among other matters, the potential size of the Platinum Term Loan increased from \$52.5 million to \$60.3 million. The Amended and Restated Platinum Credit Facility also required the use of up to \$9.8 million of KEMET's internal cash on hand for purchases

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of Notes validly tendered and not validly withdrawn pursuant to the tender offer if more than \$150.6 million aggregate principal amount of the Notes were validly tendered and not validly withdrawn and all funds under the Platinum Term Loan under the Amended and Restated Platinum Credit Facility were disbursed. As noted below, the \$150.6 million threshold was not met, and the Company did not disburse internal cash for the purchase of Notes.

On June 22, 2009, the Company announced a reduction in the minimum tender condition pursuant to the tender offer from \$122.5 million in aggregate principal amount of Notes (representing 70% of the outstanding Notes) to \$87.5 million in aggregate principal amount of Notes (representing 50% of the outstanding Notes) and an extension of the Expiration Date to June 26, 2009. All remaining terms and conditions of the tender offer were unchanged with this extension. The Company also entered into a Revised Amended and Restated Credit Agreement with K Financing, whereby, among other matters, the minimum tender condition was reduced from \$122.5 million in aggregate principal amount of Notes to \$87.5 million in aggregate principal amount of Notes.

On June 26, 2009, \$93.9 million in aggregate principal amount of the Notes were validly tendered (representing 53.7% of the outstanding Notes). As a result of the consummated tender offer, on June 30, 2009, the Company used \$37.8 million of the Platinum Term Loan under the Revised Amended and Restated Platinum Credit Facility to extinguish the tendered Notes. Proceeds of \$10.0 million from the Platinum Line of Credit Loan were used primarily to pay the fees and expenses related to execution of the tender offer and the execution of the Platinum Credit Facility. The Company incurred approximately \$3.6 million in fees and expense reimbursements related to the execution of this tender offer, \$4.2 million related to the execution of the Platinum Credit Facility, and \$1.4 million related to the amendments of the UniCredit facilities. The Company funded these costs with an equal amount of proceeds from the Platinum Line of Credit Loan. In addition, the Company will pay K Financing a success fee of \$5.0 million, payable at the time of repayment in full of the Platinum Term Loan, whether at maturity or otherwise. No monies have been drawn on the Platinum Working Capital Loan, under which the Company currently had a borrowing capacity of \$7.5 million based on the Company's book-to-bill ratio at June 30, 2009.

The Platinum Term Loan accrues interest at an annual rate of 9% for cash payment until the one-year anniversary of the consummation of the tender offer. At the Company's option, after the one-year anniversary of the consummation of the tender offer, the Platinum Term Loan will accrue interest at an annual rate of 9% for cash payment, or cash and payment in-kind (PIK) interest at the rate of 12% per annum, with the cash portion being 5% and the PIK portion being 7%. The Platinum Working Capital Loan and the Platinum Line of Credit Loan will accrue interest at a rate equal to the greater of (i) LIBOR plus 7%, or (ii) 10%, payable monthly in arrears. In the event more than \$8.8 million in aggregate principal amount of the Notes remain outstanding as of March 1, 2011, then the maturity date of the Platinum Term Loan, the Platinum Line of Credit Loan and the Platinum Working Capital Loan are accelerated to March 1, 2011. If the aggregate principal amount of the Notes outstanding at March 1, 2011 is less than or equal to \$8.8 million, the maturity date of the Platinum Term Loan will be November 15, 2012 and the maturity date for the Platinum Line of Credit Loan and the Platinum Working Capital Loan will be July 15, 2011. In addition, the Company will pay K Financing a success fee of \$5.0 million, payable at the time of repayment in full of the Platinum Term Loan, whether at maturity or otherwise. This success fee has been included in Other non-current obligations on the Condensed Consolidated Balance Sheets as of June 30, 2009.

The Revised Amended and Restated Platinum Credit Facility contains certain financial maintenance covenants, including requirements that the Company maintain a minimum consolidated EBITDA and a minimum fixed charge coverage ratio. In addition to the financial covenants, the Revised Amended and Restated Platinum Credit Facility also contains limitations on capital expenditures, the incurrence of indebtedness, the granting of liens, the sale of assets, sale and leaseback transactions, fundamental corporate changes, entering into investments, the payment of dividends, voluntary or optional payment and prepayment of indebtedness (including the Notes) and other limitations customary to secured credit facilities. These covenants will be first measured as of the end of the second quarter of the Company's current fiscal year, which is the quarter ending September 30, 2009. Based on the Company's operating plans, the Company forecasts that it will meet the financial covenants required by the Revised Amended and Restated Platinum Credit Facility and Facility A at each of the measurement dates during fiscal year 2010. However, in the case of the EBITDA covenant, the Company's forecast shows that the Company will achieve the required level of profitability by a narrow margin. The Company's forecast anticipates a steady recovery, over the next several quarters, of the principal markets

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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and industries into which its products are sold. The Company's expectations in this regard are based on various information sources including, among others, industry surveys and input from various key customers. Given the degree of uncertainty with respect to the near-term outlook for the global economy and the possible effects on the Company's operations, there is significant uncertainty as to whether the Company's forecasts will be achieved. There can be no assurance that the Company will achieve its forecasted operating profit for the balance of the year or that it will be able to meet the financial covenants required by the Revised Amended and Restated Platinum Credit Facility. In the event of a covenant breach, we would seek a waiver or amendment, but such remedy would be out of our control and at the discretion of our lender.

The Company's obligations to K Financing arising under the Revised Amended and Restated Platinum Credit Facility are secured by substantially all of the Company's assets located in the United States, Mexico, Indonesia and China (other than accounts

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receivable owing by account debtors located in the United States, Singapore and Hong Kong, which exclusively secure obligations to an affiliate of Vishay Intertechnology, Inc.). As further described in the Offer to Purchase, in connection with entering into the Revised Amended and Restated Platinum Credit Facility, K Financing and UniCredit entered into a letter of understanding with respect to their respective guarantor and collateral pools and the Company's assets in Europe that are not pledged to either lender. The letter of understanding also sets forth each lender's agreement not to interfere with the other's exercise of remedies pertaining to their respective collateral pools.

Concurrent with the consummation of the tender offer, the Company issued K Financing a warrant (the "Closing Warrant") to purchase up to 80,544,685 shares of its common stock, subject to certain adjustments, representing approximately 49.9% of the Company's outstanding common stock on a post-Closing Warrant basis. The Closing Warrant is exercisable at a purchase price of \$0.50 per share, subject to an adjustment which reduces the exercise price to a floor of \$0.35 based on a sliding scale once the aggregate borrowings under the Platinum Line of Credit Loan and the Platinum Working Capital Loan exceed \$12.5 million, at any time prior to the tenth anniversary of the Closing Warrant's date of issuance. The floor exercise price would be reached once the aggregate borrowings under the Platinum Line of Credit Loan and the Platinum Working Capital Loan reach \$20.0 million. The Closing Warrant may be exercised in exchange for cash, by means of net settlement of a corresponding portion of amounts owed by the Company under the Revised Amended and Restated Platinum Credit Facility, by cashless exercise to the extent of appreciation in the value of the Company's common stock above the exercise price of the Closing Warrant, or by combination of the preceding alternatives. The Company believes it is more likely than not that the issuance of the Closing Warrant will not be deemed an ownership change for purposes of Section 382 of the Internal Revenue Code (the "Code") although the matter is not free from doubt. In addition, the exercise of the Closing Warrant may give rise to an ownership change for purposes of Section 382 of the Code. If such an ownership change is deemed to occur, the amount of the Company's taxable income that can be offset by the Company's net operating loss carryovers in taxable years after the ownership change will be limited. The issuance of the Closing Warrant resulted in a freestanding derivative liability which will be marked to market on a quarterly basis. If the strike price becomes fixed in the future it would result in the reclassification of the warrant liability's then fair value into the line item "Additional paid-in capital" on the Condensed Consolidated Balance Sheets and it would no longer be considered a freestanding liability derivative that is marked to market on a quarterly basis. As of June 30, 2009 the fair value of the Closing Warrant is \$31.4 million and has been included in the line item "Warrant liability" on the Condensed Consolidated Balance Sheets as of June 30, 2009.

The Company also entered into an Investor Rights Agreement (the "Investor Rights Agreement") with K Financing. Pursuant to the terms of the Investor Rights Agreement, the Company has, subject to certain terms and conditions, granted Board observation rights to K Financing which would permit K Financing to designate up to three individuals to observe Board meetings and receive information provided to the Board. In addition, the Investor Rights Agreement provides K Financing with certain preemptive rights. Subject to the terms and limitations described in the Investor Rights Agreement, in connection with any proposed issuance of securities, the Company would be required to offer to sell to K Financing a pro rata portion of such securities equal to the percentage determined by dividing the number of shares of common stock held by K Financing plus the number of shares of common stock issuable upon exercise of the Closing Warrant, by the total number of shares of common stock then outstanding on a fully diluted basis. The Investor Rights Agreement also provides K Financing with certain registration and information rights.

The Company also entered into a Corporate Advisory Services Agreement with Platinum Equity Advisors, LLC ("Platinum Advisors") for a term of at least four years, pursuant to which the Company will pay an annual fee of \$1.5 million to Platinum Advisors for certain advisory services.

In accordance with SFAS No. 133 and EITF No. 07-05, the Company allocated \$31.4 million of the proceeds from the issuance of the Platinum Term Loan and the draw-down on the Platinum Line of Credit Loan to warrant liability. The Closing Warrants are accounted for as freestanding derivative liabilities. The Company allocated the remainder of the issuance proceeds to the Platinum Term Loan and the Platinum Line of Credit Loan (\$12.0 million and \$4.4 million, respectively) based upon their relative fair values. The carrying amount of the Platinum Term Loan and the Platinum Line of Credit Loan will be increased by quarterly accretion to the line item "Interest and amortization of debt discount and expense" on the Condensed Consolidated Statements of Operations under the effective interest method over their respective terms of approximately 3.4 years and 2.0 years. The carrying amount of the Platinum Term Loan and the Platinum Line of Credit approximates their fair values at June 30

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2009, based upon a discount rate present value technique (an income approach). The Company recorded deferred financing costs of \$9.2 million at the issuance date; a long-term obligation has been recognized related to the unpaid success fee. These deferred financing costs will be allocated between the various loan components and amortized under the effective interest method over the respective term.



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***Convertible Debt***

In November 2006, the Company sold and issued \$175.0 million in Convertible Senior Notes (the "Notes"). The Notes are unsecured obligations and rank equally with the Company's existing and future unsubordinated and unsecured obligations and are junior to any of the Company's future secured obligations to the extent of the value of the collateral securing such obligations. In connection with the issuance and sale of the Notes, the Company entered into an indenture (the "Indenture") dated as of November 1, 2006, with Wilmington Trust Company, as trustee.

The Notes bear interest at a rate of 2.25% per annum, payable in cash semi-annually in arrears on each May 15 and November 15. The Notes are convertible into (i) cash in an amount equal to the lesser of the principal amount of the Notes and the conversion value of the Notes on the conversion date and (ii) cash or shares of the Company's common stock ("Common Stock") or a combination of cash and shares of the Common Stock, at the Company's option, to the extent the conversion value at that time exceeds the principal amount of the Notes, at any time prior to the close of business on the business day immediately preceding the maturity date of the Notes, unless the Company has redeemed or purchased the Notes, subject to certain conditions. The initial conversion rate was 103.0928 shares of Common Stock per \$1,000 principal amount of the Notes, which represents an initial conversion price of approximately \$9.70 per share, subject to adjustments.

The holder may surrender the holder's Notes for conversion if any of the following conditions is satisfied:

- During any fiscal quarter, the closing sale price of the Common Stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter exceeds 130% of the conversion price per share on such last trading day;
- The Company has called the Notes for redemption;
- The average of the trading prices of the Notes for any five consecutive trading day period is less than 98% of the average of the conversion values of the Notes during that period;
- The Company makes certain significant distributions to the holders of the Common Stock; or
- In connection with a transaction or event constituting a "fundamental change" (as defined in the Indenture).

The Company received net proceeds from the sale of the Notes of approximately \$170.2 million, after deducting discounts and estimated offering expenses of approximately \$4.8 million. Net proceeds from the sale were used to repurchase approximately 3.3 million shares of Common Stock at a cost of approximately \$24.9 million (concurrent with the initial closing of the Notes offering). As of June 30, 2009,

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\$0.8 million in debt issuance costs related to the Notes have been recorded as Other assets in the accompanying Condensed Consolidated Balance Sheets. Debt issuance costs are being amortized over a period of five years.

Under FSP APB 14-1, the Company separated the Notes into a liability component and an equity component. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability (including any embedded features other than the conversion option) that does not have an associated equity component. The carrying amount of the equity component representing the embedded conversion option was determined by deducting the fair value of the liability component from the initial proceeds ascribed to the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount is amortized to the line item Interest and amortization of debt discount and expense over the expected life of a similar liability that does not have an associated equity component using the effective interest method. The equity component is not remeasured as long as it continues to meet the conditions for equity classification in EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Common Stock (EITF 00-19) and EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock (EITF 07-5).

Issuance and transaction costs incurred at the time of the issuance of the Notes with third parties are allocated to the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. Debt issuance costs related to the Notes, net of amortization, were \$0.8 million as of June 30, 2009 and equity issuance costs were \$1.3 million. The deferred tax liability and a corresponding valuation allowance adjustment in the same amount related to the Notes, were \$4.2 million as of June 30, 2009.

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The provisions were retroactively applied to all periods and resulted in adjustments as follows (amounts in thousands):

	As Previously Presented	March 31, 2009 Adjustment	Following the Adoption of FSP APB 14-1
<b>Consolidated Balance Sheets</b>			
<b>Assets</b>			
Other assets	\$ 7,010	\$ (650)	\$ 6,360
Total assets	714,801	(650)	714,151
<b>Liabilities</b>			
Long-term debt	307,111	(26,359)	280,752
<b>Stockholders' equity</b>			
Additional paid-in capital	322,905	44,352	367,257
Retained deficit	(62,699)	(18,643)	(81,342)
Total stockholders' equity	214,330	25,709	240,039
Total liabilities and stockholders' equity	714,801	(650)	714,151

The following table sets forth balance sheet information regarding the Notes (amounts in thousands):

	June 30, 2009	March 31, 2009 (As Adjusted)
Equity component (1)	\$ 44,352	\$ 44,352
<b>Liability Component:</b>		
Principal	\$ 81,081	\$ 175,000
Less: debt discount (2)	(11,147)	(26,359)
Net carrying amount	\$ 69,934	\$ 148,641

(1) Included in the line item "Additional paid-in capital" on the Condensed Consolidated Balance Sheets.

(2) Included in the line item "Long-term debt, less current portion" on the Condensed Consolidated Balance Sheets.

As of June 30, 2009, the remaining unamortized debt discount of the Notes will be amortized over a period of 28 months, the remaining expected term of the Notes.

The line item "Interest and amortization of debt discount and expense" on the Condensed Consolidated Statements of Operations for the quarters ended June 30, 2009 and 2008, respectively, related to the Notes is as follows (amounts in thousands):

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

		Quarters Ended June 30,	
		2009	2008
Contractual interest expense	\$	984	\$ 984
Amortization of debt issuance costs		178	178
Amortization of debt discount		2,280	2,083
Total interest expense on Notes	\$	3,442	\$ 3,245
Effective interest rate on the liability component (annualized)		9.1%	9.1%

As discussed above, on June 26, 2009, \$93.9 million in aggregate principal amount of the Notes were validly tendered (representing 53.7% of the outstanding Notes). As a result of the consummated tender offer, on June 30, 2009, the Company used the \$37.8 million Platinum Term Loan under the Revised Amended and Restated Platinum Credit Facility to extinguish the tendered Notes. The extinguishment of these Notes resulted in a net gain of \$38.9 million (\$0.48 per share) included in the line item Gain on early extinguishment of debt on the Condensed Consolidated Statements of Operations for the quarter ended June 30, 2009.

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The terms of the Notes are governed by the Indenture. The Notes mature on November 15, 2026 unless earlier redeemed, repurchased or converted. The Company may redeem the Notes for cash, either in whole or in part, anytime after November 20, 2011 at a redemption price equal to 100% of the principal amount of the Notes to be redeemed plus accrued and unpaid interest, including additional interest, if any, up to but not including the date of redemption. In addition, holders of the Notes will have the right to require the Company to repurchase for cash all or a portion of their Notes on November 15, 2011, 2016 and 2021, at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, in each case, up to but not including, the date of repurchase.

The Notes are convertible into Common Stock at a rate equal to 103.0928 shares per \$1,000 principal amount of the Notes (equal to an initial conversion price of approximately \$9.70 per share), subject to adjustment as described in the Indenture. Upon conversion, the Company will deliver for each \$1,000 principal amount of Notes, an amount consisting of cash equal to the lesser of \$1,000 and the conversion value (as defined in the Indenture) and, to the extent that the conversion value exceeds \$1,000, at the Company's election, cash or shares of Common Stock with respect to the remainder. Pursuant to EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially settled in, a Company's own stock*, the contingent conversion feature was not required to be bifurcated and accounted for separately under the provisions of SFAS No. 133.

If the Company undergoes a fundamental change, holders of the Notes will have the right, subject to certain conditions, to require the Company to repurchase for cash all or a portion of their Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased plus accrued and unpaid interest, including contingent interest and additional amounts, if any. The Company would pay a make-whole premium on the Notes converted in connection with any fundamental change that occurs prior to November 20, 2011. The amount of the make-whole premium, if any, will be based on the Company's stock price and the effective date of the fundamental change. The maximum make-whole premium, expressed as a number of additional shares of the Common Stock to be received per \$1,000 principal amount of the Notes, would be 30.95 upon the conversion of Notes in connection with the occurrence of a fundamental change prior to November 1, 2006, November 15 of each of 2007, 2008, 2009 or 2010, respectively, or November 20, 2011 if the stock price at that date is \$7.46 per share of Common Stock. The Indenture contains a detailed description of how the make-whole premium will be determined and a table showing the make-whole premium that would apply at various stock prices and fundamental change effective dates. No make-whole premium will be paid if the price of the common stock on the effective date of the fundamental change is less than \$7.46. Any make-whole premium will be payable in shares of common stock (or the consideration into which the Company's common stock has been exchanged in the fundamental change) on the conversion date for the Notes converted in connection with the fundamental change. The approximate fair value of the outstanding Notes, based on quoted market prices close to June 30, 2009, was \$37 million. The Company had interest payable related to the Notes included in Accrued expenses on the Condensed Consolidated Balance Sheets of approximately \$0.2 million and \$1.5 million at June 30, 2009 and March 31, 2009, respectively.

## **UniCredit**

In October 2007, in connection with the completion of the acquisition of Arcotronics Italia S.p.A. (Arcotronics), the Company entered into a Senior Facility Agreement (Facility B) with UniCredit whereby UniCredit agreed to lend to the Company up to EUR 47 million (\$66.4 million). The Company's initial drawdown of EUR 45.8 million (\$64.7 million) was used to repay certain outstanding indebtedness of Arcotronics and for general corporate purposes. On December 20, 2007, the Company borrowed an additional EUR 1.0 million (\$1.4 million) in connection with the refinancing of certain third party indebtedness.

In December 2007, in connection with the refinancing of certain third party indebtedness acquired as part of the acquisition of Arcotronics, the Company entered into a credit facility with UniCredit whereby UniCredit agreed to lend to the Company EUR 50 million (\$70.7 million). The Company used the proceeds from this borrowing, together with cash on hand and the drawdown of EUR 1.0 million (\$1.4 million) under a separate credit facility with UniCredit, to refinance third party indebtedness of Arcotronics.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

In October 2008, the Company entered into a new medium-term credit facility in the principal amount of EUR 60 million (\$84.6 million) ( Facility A ) with UniCredit. Facility A is effective for a four and one-half year term with the first payment due April 1, 2009 and terminates on April 1, 2013. Proceeds from Facility A in the amount of EUR 50 million (\$70.7 million) were used to pay off the above mentioned separate credit facility with UniCredit with a scheduled maturity date of December 2008. Additional proceeds from Facility A in the amount of EUR 10.0 million (\$14.1 million) were applied to reduce the outstanding principal of Facility B with UniCredit with a scheduled maturity date of April 2009.

On April 3, 2009, the Company entered into an agreement to extend and restructure Facility B. Facility B remained unsecured and does not contain any covenants, however it contains cross acceleration provisions linked to Facility A, and bears interest at a rate of six-month EURIBOR plus 2.5 percent. Like Facility A, Facility B includes a subjective acceleration clause.

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In April 2009, the Company also entered into amendments to Facility A and Facility B with UniCredit which, among other things, modified the financial covenants under Facility A and modified the scheduled amortization under Facility A and Facility B. These amendments to the UniCredit facilities became effective June 30, 2009 upon the consummation of the tender offer.

Material terms and conditions of Facility A are as follows:

- (i) Maturity: April 1, 2013
- (ii) Interest Rate: Floating at six-month EURIBOR plus 2.5%
- (iii) Amortization: EUR 14.3 million, EUR 10.2 million, EUR 6.2 million and EUR 23.5 million in fiscal years 2011, 2012, 2013 and 2014, respectively.
- (iv) Structure: Secured with Italian real property, certain European accounts receivable and shares of two of the Company's Italian subsidiaries

Terms and conditions of Facility B are as follows:

- (i) Maturity: April 1, 2013
- (ii) Interest Rate: Floating at six-month EURIBOR plus 2.5%
- (iii) Amortization: EUR 2.0 million, EUR 4.0 million, EUR 10.0 million, EUR 10.0 million and EUR 9.0 million in fiscal years 2010, 2011, 2012, 2013 and 2014, respectively.
- (iv) Structure: Unsecured

The Company is subject to covenants under Facility A which, among other things, restrict its ability to make capital expenditures above certain thresholds and require it to meet financial tests related principally to a fixed charge coverage ratio and profitability. The first measurement date for these financial tests will be September 30, 2009. Thereafter, the measurement date will occur every three months.

The occurrence of events that significantly compromise the Company's financial, economic, asset or operating situation and significantly compromise the Company's ability to ensure prompt and regular repayment of Facility A allow UniCredit to accelerate repayment of Facility A. The Company deems the foregoing provision of Facility A to be a subjective acceleration clause and has assessed the likelihood of whether or not it will be exercised. While the Company does not presently expect UniCredit to exercise its rights under this clause within the next twelve months, there can be no assurance that UniCredit will not exercise their rights. There are also provisions under Facility A which require the Company's continued listing on a stock exchange or regulated stock market existing in the U.S. The Company's listing on the OTC Bulletin Board complies with the covenants under Facility A.

The approximate combined fair value of Facility A and Facility B, based upon a discount rate present value technique (an income approach), as of June 30, 2009, is \$71 million.

***Vishay***

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In the second quarter of fiscal year 2009, the Company sold assets related to the production and sale of wet tantalum capacitors to a subsidiary of Vishay. The Company received \$33.7 million in cash proceeds, net of amounts held in escrow, from the sale of these assets. At the same time, the Company entered into a three-year term loan agreement for \$15.0 million and a security agreement with Vishay. The loan carries an interest rate of LIBOR plus 4% which is payable monthly. The entire principal amount of \$15.0 million matures on September 15, 2011 and can be prepaid without penalty. Pursuant to the security agreement, the loan is secured by certain accounts receivable of the Company. The approximate fair value of this loan, based on a discount rate present value technique (an income approach), as of June 30, 2009 is \$9 million.



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**Note 3. Segment and Geographic Information**

The Company is organized into three distinct business groups: the Tantalum Business Group ( Tantalum ), the Ceramic Business Group ( Ceramic ), and the Film and Electrolytic Business Group ( Film and Electrolytic ). Each business group is responsible for the operations of certain manufacturing sites as well as all related research and development efforts. The sales and marketing functions are shared by the business groups and are allocated to each business group based on the business groups' respective budgeted net sales. In addition, all corporate costs are allocated to the business groups based on the business groups' respective budgeted net sales. On April 24, 2007, the Company acquired Evox Rifa Group Oyj and on October 12, 2007, the Company acquired Arcotronics Italia S.p.A. Evox Rifa and Arcotronics make up Film and Electrolytic.

*Tantalum*

Tantalum operates in eight manufacturing sites in the United States, Mexico, China, and Portugal. This business group produces tantalum and aluminum polymer capacitors. The business group also maintains a product innovation center in the United States. Tantalum products are sold in all regions of the world.

*Ceramic*

Ceramic operates in two manufacturing locations in Mexico. This business group produces ceramic capacitors. In addition, the business group has a product innovation center in the United States. Ceramic products are sold in all regions of the world.

*Film and Electrolytic*

Film and Electrolytic operates in thirteen manufacturing sites in Europe and Asia. This business group produces film, paper, and electrolytic capacitors. In addition, the business group has a product innovation center in Sweden. Film and Electrolytic products are sold in all regions in the world.

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The following table reflects each business group's net sales, operating (loss) income, depreciation and amortization expenses and total assets as well as sales by region for the quarters ended June 30, 2009 and 2008 (amounts in thousands):

	Quarters Ended June 30,	
	2009	2008 (As Adjusted)
<b>Net sales:</b>		
Tantalum	\$ 72,368	\$ 108,843
Ceramic	32,948	53,205
Film and Electrolytic	44,851	80,796
	\$ 150,167	\$ 242,844
<b>Operating income (loss) (1)(2):</b>		
Tantalum	\$ 3,802	\$ (4,289)
Ceramic	2,448	(87,602)
Film and Electrolytic	(8,751)	(88,740)
	\$ (2,501)	\$ (180,631)
<b>Depreciation and amortization expenses:</b>		
Tantalum	\$ 7,232	\$ 8,081
Ceramic	2,415	3,801
Film and Electrolytic	2,631	3,770
	\$ 12,278	\$ 15,652
<b>Sales by region:</b>		
North and South America (Americas)	\$ 36,122	\$ 57,309
Europe, Middle East, Africa (EMEA)	54,667	101,692
Asia and Pacific Rim (APAC)	59,378	83,843
	\$ 150,167	\$ 242,844

	June 30, 2009	March 31, 2009 (As Adjusted)
<b>Total assets:</b>		
Tantalum	\$ 373,033	\$ 357,075
Ceramic	156,659	155,558
Film and Electrolytic	193,411	201,518
	\$ 723,103	\$ 714,151

(1) Restructuring charges included in Operating income (loss) were as follows:

	Quarters Ended June 30,	
	2009	2008
<b>Total restructuring:</b>		
Tantalum	\$	\$ 1,298
Ceramic		676
Film and Electrolytic		4,823
	\$	\$ 6,797

(2) Impairment charges and write downs included in Operating income (loss) were as follows:

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

	Quarters Ended June 30,	
	2009	2008
<b>Impairment charges and write downs:</b>		
Tantalum	\$	\$
Ceramic		76,346
Film and Electrolytic		76,229
	\$	\$ 152,575

Table of Contents**Note 4. Restructuring Charges**

During the past several fiscal years, the Company has initiated several restructuring programs (the Plan) in order to reduce costs, remove excess capacity and make the Company more competitive on a worldwide basis. Since the goals of each of these restructuring programs fall into one of the rationales listed above, the Company has elected to disclose the quarterly impact of total restructuring rather than by each restructuring program. The Plan is substantially complete with the exception of paying the remaining severance obligations and minor costs for equipment relocation.

A reconciliation of the beginning and ending liability balances for the Plan for the quarters ended June 30, 2009 and 2008 is shown below (amounts in thousands):

	Quarter Ended June 30, 2009		Quarter Ended June 30, 2008	
	Personnel Reductions	Manufacturing Relocations	Personnel Reductions	Manufacturing Relocations
Beginning of period	\$ 7,893	\$	\$ 1,835	\$
Costs charged to expense			4,939	1,858
Costs paid or settled	(2,279)		(2,800)	(1,858)
Change in foreign exchange	323		78	
End of period	\$ 5,937	\$	\$ 4,052	\$

**Note 5. Accumulated Other Comprehensive Income**

Comprehensive income (loss) for the quarters ended June 30, 2009 and 2008, includes the following components (amounts in thousands):

	Quarter Ended June 30,	
	2009	2008 (As Adjusted)
Net income (loss)	\$ 25,090	\$ (189,375)
Amortization of postretirement benefit plan	(87)	(610)
Currency forward contract gain		750
Currency translation gain (loss)	6,508	(395)
Total net income (loss) and other comprehensive income (loss)	\$ 31,511	\$ (189,630)

The components of Accumulated other comprehensive income on the Condensed Consolidated Balance Sheets are as follows (amounts in thousands):

	June 30, 2009	March 31, 2009
Foreign currency translation gain	\$ 18,723	\$ 12,215
Defined benefit postretirement plan adjustments	2,884	2,971

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Defined benefit pension plans		(2,523)		(2,523)
Total Accumulated other comprehensive income	\$	19,084	\$	12,663

Table of Contents**Note 6. Intangible Assets**

The following table highlights the Company's intangible assets (amounts in thousands):

	June 30, 2009		March 31, 2009	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Trademarks	\$ 7,617	\$	\$ 7,617	\$
Amortized intangibles (2-25 years)	20,699	3,898	21,447	4,970
	\$ 28,316	\$ 3,898	\$ 29,064	\$ 4,970

**Note 7. Income Taxes**

During the quarter ended June 30, 2009, the net income tax expense of \$1.0 million is comprised of \$0.9 million of tax expense related to foreign operations and \$0.1 million of state income tax expense. The income related to the U.S. gain from the early extinguishment of debt did not result in any Federal regular current or deferred income tax expense due to the utilization of net operating loss carryforwards which have valuation allowances. Additionally, we recorded valuation allowances to partially offset the income tax benefit related to net operating losses in some of our foreign subsidiaries because it is considered more likely than not that these future benefits will not be realized.

**Note 8. Concentrations of Risks***Sales and Credit Risk*

The Company sells to customers globally. Credit evaluations of the Company's customers' financial condition are performed periodically, and the Company generally does not require collateral from the Company's customers. There were no customers which accounted for over 10% of the Company's net sales in the first quarter of fiscal year 2010. There were no customers' accounts receivable balances exceeding 10% of gross accounts receivable at June 30, 2009 or at March 31, 2009.

Electronics distributors are an important distribution channel in the electronics industry and accounted for 46% and 48% of the Company's net sales in the quarters ended June 30, 2009 and 2008, respectively. As a result of the Company's concentration of sales to electronics distributors, the Company may experience fluctuations in the Company's operating results as electronics distributors experience fluctuations in end-market demand or adjust their inventory stocking levels.

**Note 9. Stock-based Compensation**

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, depending on the terms and conditions of the warrants.

***2009/2010 LTIP***

During the first quarter of fiscal year 2009, the Board of Directors approved a new long-term incentive plan ( 2009/2010 LTIP ) based upon the achievement of an earnings per share target for the combined fiscal years ending in March 2009 and 2010. The Company assessed the likelihood of meeting the target financial metrics and concluded that as of the quarter ended June 30, 2009, the target would not be achieved. Accordingly, no compensation expense was recorded during the first quarter of fiscal year 2010. The Company will continue to monitor the likelihood of whether the target financial metrics will be realized and will adjust compensation expense to match expectations. Any awards issued would vest on the measurement date of May 15, 2010.

***Restricted Stock***

The Company's Chief Executive Officer was granted 50 thousand restricted shares of KEMET common stock on April 6, 2009. The shares vested immediately upon grant and had a weighted-average issuance price of \$0.29 per share. Compensation expense associated with the grants was \$15 thousand and is included in the line item Selling, general and administrative expense on the Condensed Consolidated Statements of Operations.

***Stock Options***

At March 31, 2009, the Company had three option plans that reserved shares of common stock for issuance to executives and key employees: the 1992 Key Employee Stock Option Plan, the 1995 Executive Stock Option Plan, and the 2004 Long-Term Equity Incentive Plan. All of these plans were approved by the Company's shareholders. These plans authorized the grant of up to

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12.1 million shares of the Company's common stock. The Company has no plans to purchase additional shares in conjunction with its employee stock option program in the near future. Options issued under these plans vest in one or two years and expire ten years from the grant date.

The Company did not grant any stock options during the first quarter of fiscal year 2010. The compensation expense associated with option awards granted in previous years was \$0.2 million and \$0.4 million for the quarters ended June 30, 2009 and 2008, respectively. These costs were recorded as Selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

In the Operating activities section of the Condensed Consolidated Statements of Cash Flows, stock-based compensation expense was treated as an adjustment to net income for the quarter ended June 30, 2009 and 2008. No tax benefit was realized from stock options exercised during the quarters ended June 30, 2009 and 2008.

**Note 10. Reconciliation of Basic and Diluted Income (Loss) Per Common Share**

In accordance with FASB Statement No. 128, Earnings per Share, the following table presents a reconciliation of basic EPS to diluted EPS.

**Computation of Basic and Diluted Income (Loss) Per Share**

(Amounts in thousands, except per share data)

	Quarters Ended June 30, 2008					
	2009	(As Adjusted)				
Numerator:						
Net income (loss)	\$ 25,090	\$ (189,375)				
Denominator:						
Weighted-average shares outstanding:						
Basic	80,864	80,398				
Assumed conversion of employee stock options						
Diluted	80,864	80,398				
		2016		2018 vs. 2017	2017 vs. 2016	
Revenue	\$ 1,615	\$ 1,556	\$ 1,480	4 %	5 %	
Costs and expenses:						
Cost of revenue	86	72	71	19 %	1 %	
Selling and marketing	778	849	756	(8 )%	12 %	
Technology and content	275	243	243	13 %	0 %	
General and administrative	177	157	143	13 %	10 %	
Depreciation	82	79	69	4 %	14 %	

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



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Amortization of intangible assets	34	32	32	6 %	0 %
Total costs and expenses	1,432	1,432	1,314	0 %	9 %
Operating income	183	124	166	48 %	(25 )%
Other income (expense):					
Interest expense	(12 )	(15 )	(12 )	(20 )%	25 %
Interest income and other, net	2	1	(3 )	100 %	n.m.
Total other income (expense), net	(10 )	(14 )	(15 )	(29 )%	(7 )%
Income before income taxes	173	110	151	57 %	(27 )%
Provision for income taxes	(60 )	(129 )	(31 )	(53 )%	316%
Net income (loss)	\$ 113	\$ (19 )	\$ 120	n.m.	n.m.
Earnings (loss) per share attributable to common stockholders:					
Basic	\$ 0.82	\$ (0.14 )	\$ 0.83	n.m.	n.m.
Diluted	\$ 0.81	\$ (0.14 )	\$ 0.82	n.m.	n.m.
Other financial data:					
Adjusted EBITDA (1)	\$ 422	\$ 331	\$ 352	27 %	(6 )%

n.m. = not meaningful

(1)See “Adjusted EBITDA” discussion below for more information.

Revenue and Segment Information

	Year ended December 31,			% Change		
	2018	2017	2016	2018 vs. 2017	2017 vs. 2016	
Revenue by Segment:	(in millions)					
Hotel	\$1,157	\$1,196	\$1,190	(3 )%	1	%
Non-Hotel	458	360	290	27 %	24	%
Total revenue	\$1,615	\$1,556	\$1,480	4 %	5	%
Adjusted EBITDA by Segment (1):						
Hotel	\$356	\$286	\$380	24 %	(25	)%
Non-Hotel	66	45	(28 )	47 %	n.m.	
Adjusted EBITDA Margin by Segment (2):						
Hotel	31 %	24 %	32 %			
Non-Hotel	14 %	13 %	(10 )%			

n.m. = not meaningful



(1) Included in Adjusted EBITDA is a general and administrative expense allocation for each segment, which is based on the segment's percentage of our total personnel costs, excluding stock-based compensation. Refer to "Note 18: Segment and Geographic Information," in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for more information.

(2) We define "Adjusted EBITDA Margin by Segment", as Adjusted EBITDA by segment divided by Revenue by segment.

#### Hotel Segment

Our Hotel segment revenue decreased \$39 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to a \$34 million decrease in TripAdvisor-branded click-based and transaction revenue and \$21 million decrease in other Hotel revenue, partially offset by \$16 million increase in TripAdvisor-branded display-based advertising and subscription revenue, all of which are discussed below. Our Hotel segment revenue increased \$6 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to \$6 million increase in TripAdvisor-branded click-based and transaction revenue and \$10 million increase in TripAdvisor-branded display-based advertising and subscription revenue, partially offset by a decrease of \$10 million in other Hotel revenue, all of which are discussed below.

Adjusted EBITDA and Adjusted EBITDA margin in our Hotel segment increased \$70 million and to 31%, respectively, during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to a decrease in our direct selling and marketing expenses related to SEM and other online paid traffic acquisition costs as we have continued to optimize and improve our marketing efficiency from our online marketing campaigns and, to a lesser extent, growth in our TripAdvisor-branded display-based advertising and subscription revenue. Adjusted EBITDA and Adjusted EBITDA margin in our Hotel segment decreased \$94 million and to 24%, respectively, during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to costs related to our television campaign, which launched in June 2017, and also due to increased SEM and other online traffic acquisition costs during the first half of 2017, partially offset by cost savings created through optimization and improved marketing efficiencies of our online marketing campaigns during the second half of 2017.

The following is a detailed discussion of the revenue sources within our Hotel segment:

	Year ended December 31,			% Change	
	2018	2017	2016	2018 vs 2017	2017 vs 2016
Hotel:	(in millions)				
TripAdvisor-branded click-based and transaction	\$722	\$756	\$750	(4 %)	1 %
TripAdvisor-branded display-based advertising and subscription	308	292	282	5 %	4 %
Other Hotel revenue	127	148	158	(14 %)	(6 %)
Total Hotel revenue	\$1,157	\$1,196	\$1,190	(3 %)	1 %

#### TripAdvisor-branded Click-based and Transaction Revenue

TripAdvisor-branded click-based and transaction revenue includes CPC-advertising revenue from our TripAdvisor-branded websites as well as transaction-based revenue from our hotel instant booking feature. For the years ended December 31, 2018, 2017 and 2016, 62%, 63% and 63%, respectively, of our Hotel segment revenue was

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derived from our TripAdvisor-branded click-based and transaction revenue. TripAdvisor-branded click-based and transaction revenue decreased \$34 million or 4% during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to a 4% decrease in our average monthly unique hotel shoppers as well as a 2% decrease in our revenue per hotel shopper during the year ended December 31, 2018, which is explained below. TripAdvisor-branded click-based and transaction revenue increased \$6 million or 1% during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to an increase in our average monthly unique hotel shoppers of 10%, which was largely offset by a decrease of 9% in our revenue per hotel shopper during the year ended December 31, 2017, which is explained below.

Our largest source of Hotel segment revenue is click-based advertising revenue from our TripAdvisor-branded websites, which include links to our travel partners' sites and contextually-relevant branded and related text links. Click-based advertising is generated primarily through our metasearch auction, a description of which follows. Our

click-based travel partners are predominantly OTAs and hoteliers. Click-based advertising is generally priced on a CPC basis, with payments to us from advertisers based on the number of consumer clicks on each type of link or, in other words, the conversion of a hotel shopper to a paid click. CPC is the price that a partner is willing to pay us for a hotel shopper lead, which is determined in a competitive process as partner CPC bids for rates and availability listed on our site are submitted. When a CPC bid is submitted, the partner agrees to pay us the bid amount each time a consumer clicks on the link to that partner's website. Bids can be submitted periodically – as often as daily – on a property-by-property basis. Primary factors used to determine the placement of partner links on our site include, but are not limited to, nightly room rate, the size of the bid relative to other bids, and other variables. Hotel shoppers visiting via mobile phones currently monetize at a significantly lower rate than hotel shoppers visiting via desktop or tablet. Our Hotel segment transaction-based revenue is comprised of revenue from our hotel instant booking feature, which enables the merchant of record, generally an OTA or hotel partner, to pay a pre-determined commission rate to TripAdvisor for each consumer that completes a hotel reservation via our website.

The key drivers of TripAdvisor-branded click-based and transaction revenue include average monthly unique hotel shoppers and revenue per hotel shopper, the latter of which measures how effectively we convert our hotel shoppers into revenue. We measure performance by calculating revenue per hotel shopper on an aggregate basis by dividing total TripAdvisor-branded click-based and transaction revenue by total average monthly unique hotel shoppers on TripAdvisor-branded websites for the periods presented.

While we believe that total traffic growth, or growth in monthly visits from unique visitors, is reflective of our overall brand growth, we also track and analyze sub-segments of our traffic and their correlation to revenue generation and utilize data regarding hotel shoppers as one of the key indicators of revenue growth. Hotel shoppers are visitors who view either a listing of hotels in a city or on a specific hotel page. The number of hotel shoppers tends to vary based on seasonality of the travel industry and general economic conditions, as well as other factors outside of our control.

The table below summarizes our revenue per hotel shopper calculation and growth rate, in the aggregate, for the periods presented (in millions, except calculated revenue per hotel shopper and percentages):

	Year ended December 31,			% Change	
	2018	2017	2016	2018 vs 2017	2017 vs 2016
	(in millions)				
Revenue per hotel shopper:					
TripAdvisor-branded click-based and transaction revenue	\$722	\$756	\$750	(4%)	1%
Divided by: Total average monthly unique hotel shoppers for the year	1,742	1,814	1,645	(4%)	10%
	\$0.41	\$0.42	\$0.46	(2%)	(9%)

#### 2018 vs. 2017

Revenue per hotel shopper decreased 2% during the year ended December 31, 2018 when compared to the same period in 2017, according to our internal log files. The decrease was primarily driven by travel partners bidding to lower CPCs in our click-based metasearch auction during the second half of 2017, which created difficult year-over-year growth comparisons during the first half of 2018, as well as a greater percentage of hotel shoppers visiting TripAdvisor-branded websites and apps on mobile phones, partially offset by our success in product

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

improvements and increasing traffic quality, as discussed above.

Our aggregate average monthly unique hotel shoppers on TripAdvisor-branded websites decreased by 4% during the year ended December 31, 2018 when compared to the same period in 2017, according to our internal log files. The decrease was primarily due to significantly reducing our direct marketing spend on our least-profitable paid online marketing campaigns, as well as product enhancements focused on increasing traffic quality, which we believe limits our ability to grow hotel shoppers in the near term, as discussed above, partially offset by the general trend of an increasing number of hotel shoppers visiting our websites and apps on mobile phones which we continued to experience during 2018.

2017 vs. 2016

Revenue per hotel shopper decreased 9% during the year ended December 31, 2017 when compared to the same period in 2016, according to our internal log files. The decrease was primarily driven by travel partners bidding to lower CPCs in our click-based metasearch auction during the second half of 2017, and the general trend of a greater percentage of hotel shoppers visiting TripAdvisor-branded websites and apps on mobile phones, which grew significantly faster than traffic from desktop and tablet devices, as well as dilution from product testing related to the second-quarter 2017 launch of our redesigned website and apps, and the timing of our hotel instant booking feature rollout in certain non-U.S. markets during the first half of 2016.

Our aggregate average monthly unique hotel shoppers on TripAdvisor-branded websites increased by 10% during the year ended December 31, 2017 when compared to the same period in 2016, according to our internal log files. The increase in hotel shoppers is primarily due to the general trend of an increasing number of hotel shoppers visiting our websites on mobile phones, as well as growth in our paid online marketing channels, partially offset by marketing spend tradeoffs resulting from increased brand advertising investment in our television campaign, as discussed above.

#### TripAdvisor-branded Display-based Advertising and Subscription Revenue

For the years ended December 31, 2018, 2017 and 2016, 27%, 24% and 24%, respectively, of our Hotel segment revenue was derived from our TripAdvisor-branded display-based advertising and subscription revenue, which primarily consists of revenue from display-based advertising and subscription-based hotel advertising revenue.

2018 vs. 2017

Our TripAdvisor-branded display-based advertising and subscription revenue increased by \$16 million or 5%, during the year ended December 31, 2018 when compared to the same period in 2017, primarily attributable to revenue from our new media ad product during 2018, which enables hotels to enhance their visibility on TripAdvisor hotel pages. The increase was partially offset by the general trend of an increasing percentage of our traffic visiting our websites on mobile phones, which yield smaller impression opportunities due to the smaller screen size.

2017 vs. 2016

Our TripAdvisor-branded display-based advertising and subscription revenue increased by \$10 million or 4%, during the year ended December 31, 2017 when compared to the same period in 2016. The increase in display-based advertising revenue was primarily due to an increase in impressions sold, as well as an increase in pricing, partially offset by the general trend of an increasing percentage of our traffic visiting our websites on mobile phones, in addition to hotel industry consolidation.

#### Other Hotel Revenue

For the years ended December 31, 2018, 2017 and 2016, 11%, 12% and 13%, respectively, of our Hotel segment revenue was derived from other Hotel revenue. Our other Hotel revenue primarily includes revenue from non-TripAdvisor branded websites, such as bookingbuddy.com, cruisecritic.com, onetime.com, and smartertravel.com, primarily through click-based advertising and display-based advertising. Other Hotel revenue decreased by \$21 million and \$10 million during the years ended December 31, 2018 and 2017, respectively, when compared to the same periods in 2017 and 2016, primarily due to increased marketing efficiency from paid online marketing channels, and in 2018, increased with the elimination of some marginal and unprofitable revenue within



these offerings, in addition to realignment of certain capital resources within the Hotel segment. These steps have resulted in increased profitability within the Hotel segment; however, these changes have had an adverse impact on other Hotel revenue performance in 2018 and 2017.

## Non-Hotel Segment

For the years ended December 31, 2018, 2017 and 2016, our Non-Hotel segment revenue accounted for 28%, 23% and 20%, respectively, of our total consolidated revenue. Our Non-Hotel segment revenue increased by \$98 million or 27% and \$70 million or 24%, for the years ended December 31, 2018 and 2017, respectively, when compared to the same periods in 2017 and 2016, respectively, driven by Experiences and Restaurants, as we continue our investment in product, bookable supply and marketing.

Experiences continued to generate strong revenue due to increased growth in bookings, which was primarily driven by an increased and greater selection of bookable supply, and growth in demand from bookings sourced by TripAdvisor. Another contributing factor was the key feature improvements made to the shopping experience, which improvements are ongoing. In addition, we launched a new supplier platform during the fourth quarter of 2018, which increased the efficiency with which suppliers can participate and market their bookable experiences, thereby offering consumers a greater selection of travel activities and experiences. Continued strong revenue growth in Restaurants was primarily due to seated diner growth, mobile bookings growth, user experience improvements, and increased bookable supply of restaurant listings, as well as increased revenue from TripAdvisor websites. Rentals' revenue decreased during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to increasing competition in the alternative accommodations marketplace and our strategic re-allocation of resources within the Non-Hotel segment to support growth in Experiences and Restaurants, and to a lesser extent the continued migration of our subscription model to our free-to-list model. Revenue in our Rentals offering decreased slightly during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to the continued migration of our subscription model to our free-to-list model, in addition to a slower growth rate in our free-to-list revenues than 2016.

Adjusted EBITDA and Adjusted EBITDA margin in our Non-Hotel segment increased \$21 million and to 14%, respectively, during the year ended December 31, 2018 when compared to the same period in 2017. This increase was primarily driven by the increase in our Non-Hotel segment revenue, partially offset primarily by increased personnel and overhead costs of \$41 million, to support growth in this segment during the year ended December 31, 2018, as well as an increase in online advertising costs. Adjusted EBITDA and Adjusted EBITDA margin in our Non-Hotel segment increased \$73 million and to 13%, respectively, during the year ended December 31, 2017 when compared to the same period in 2016. This increase was primarily driven by the increase in our Non-Hotel segment revenue, in addition to increased efficiencies in paid online marketing channels and other operational synergies across our Experiences and Rentals offerings, partially offset by increased personnel and overhead costs to support growth in this segment for the year ended December 31, 2017.

## Consolidated Expenses

### Cost of Revenue

Cost of revenue consists of expenses that are directly related or closely correlated to revenue generation, including direct costs, such as credit card and other booking transaction payment fees, data center costs, costs associated with prepaid tour tickets, ad serving fees, flight search fees, and other transaction costs. In addition, cost of revenue includes personnel and overhead expenses, including salaries, benefits, stock-based compensation and bonuses for certain customer support personnel who are directly involved in revenue generation.

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	Year ended December 31,			% Change		
				2018	2017	
				vs	vs	
	2018	2017	2016	2017	2016	
	(in millions)					
Direct costs	\$67	\$53	\$51	26%	4	%
Personnel and overhead	19	19	20	0	(5	%)
Total cost of revenue	\$86	\$72	\$71	19%	1	%
% of revenue	5.3%	4.6%	4.8%			

## 2018 vs. 2017

Cost of revenue increased \$14 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to increased direct costs associated with prepaid tour tickets and merchant credit card and other transaction payment processing fees as a result of revenue growth in our Non-Hotel segment and, to a lesser extent, an increase in transaction costs related to revenue generation in our Hotel segment.

## 2017 vs. 2016

Cost of revenue increased \$1 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to increased direct costs from merchant credit card and other transaction payment processing fees as a result of revenue growth in our Non-Hotel segment.

## Selling and Marketing

Selling and marketing expenses primarily consist of direct costs, including traffic generation costs from SEM and other online traffic acquisition costs, syndication costs and affiliate program commissions, social media costs, brand advertising, television and other offline advertising, promotions and public relations. In addition, our sales and marketing expenses consist of indirect costs such as personnel and overhead expenses, including salaries, commissions, benefits, stock-based compensation expense, and bonuses for sales, sales support, customer support and marketing employees.

	Year ended December 31,			% Change	
	2018	2017	2016	2018 vs 2017	2017 vs 2016
	(in millions)				
Direct costs	\$553	\$639	\$554	(13 %)	15 %
Personnel and overhead	225	210	202	7 %	4 %
Total selling and marketing	\$778	\$849	\$756	(8 %)	12 %
% of revenue	48.2 %	54.6 %	51.1 %		

## 2018 vs. 2017

Direct selling and marketing costs decreased \$86 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to decreased SEM and online traffic acquisition costs in our Hotel segment, partially offset by an increase in our Hotel segment television advertising campaign spend of \$40 million during the year ended December 31, 2018, and by an increase in online and offline advertising costs in our Non-Hotel segment during the year ended December 31, 2018 when compared to the same period in 2017. Personnel and overhead costs increased \$15 million during the year ended December 31, 2018 when compared to the same period in 2017, due to an increase in headcount in our Non-Hotel segment to support business growth.

## 2017 vs. 2016

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

Direct selling and marketing costs increased \$85 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to costs incurred related to the launch of a new television campaign in June of 2017, as well as an increase in SEM and other online traffic acquisition costs in our Hotel segment during the first half of 2017, partially offset by a decrease in other advertising costs. We spent \$74 million on our television advertising campaign during the year ended December 31, 2017 attributable to our Hotel segment, which we did not incur during the year ended December 31, 2016.

#### Technology and Content

Technology and content expenses consist primarily of personnel and overhead expenses, including salaries and benefits, stock-based compensation expense, and bonuses for salaried employees and contractors engaged in the

design, development, testing, content support, and maintenance of our websites and mobile apps. Other costs include licensing, maintenance expense, computer supplies, telecom costs, content translation costs, and consulting costs.

	Year ended December 31,			% Change	
	2018	2017	2016	2018 vs 2017	2017 vs 2016
	(in millions)				
Personnel and overhead	\$246	\$219	\$213	12%	3%
Other	29	24	30	21%	(20)%
Total technology and content	\$275	\$243	\$243	13%	0%
% of revenue	17.0%	15.6%	16.4%		

#### 2018 vs. 2017

Technology and content costs increased \$32 million during the year ended December 31, 2018 when compared to the same period in 2017 primarily due to increased personnel and overhead costs, which includes an increase in stock-based compensation of \$11 million for the year ended December 31, 2018, primarily as a result of an increase in headcount to support business growth in our Non-Hotel segment. Other costs increased by \$5 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to an increase in software and other professional licensing costs.

#### 2017 vs. 2016

Technology and content costs remained flat during the year ended December 31, 2017 when compared to the same period in 2016. Personnel and overhead costs increased \$6 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily to support our mobile phone and website initiatives, as well as to support business growth, partially offset by a decrease in contingent staff costs. Other costs decreased by \$6 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to a decrease in content translation costs.

#### General and Administrative

General and administrative expenses consist primarily of personnel and related overhead costs, including personnel engaged in leadership, finance, legal, and human resources, as well as stock-based compensation expense for those same personnel. General and administrative costs also include professional service fees and other fees including audit, legal, tax and accounting, and other costs including bad debt expense, non-income taxes, such as sales, use and other non-income related taxes.

Year ended December 31,	% Change
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Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

				2018 vs 2017	2017 vs 2016
	2018	2017	2016		
	(in millions)				
Personnel and overhead	\$129	\$116	\$101	11 %	15 %
Professional service fees and other	48	41	42	17 %	(2 %)
Total general and administrative	\$177	\$157	\$143	13 %	10 %
% of revenue	11.0 %	10.1 %	9.7 %		

## 2018 vs. 2017

General and administrative costs increased \$20 million during the year ended December 31, 2018 when compared to the same period in 2017. Personnel costs and overhead costs increased \$13 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to an increase in stock-based compensation of \$10 million, which was primarily as a result of equity awards granted to our CEO in November 2017. Professional service fees and other increased \$7 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to an increase of \$5 million in legal settlements and to a lesser extent an increase in bad debt expense.

## 2017 vs. 2016

General and administrative costs increased \$14 million during the year ended December 31, 2017 when compared to the same period in 2016. Personnel costs and overhead costs increased \$15 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily related to an increase in stock-based compensation of \$10 million. Professional service fees and other decreased \$1 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to a decrease in consulting costs and non-income taxes, partially offset by an increase in bad debt expense.

## Depreciation

Depreciation expense consists of depreciation on computer equipment, leasehold improvements, furniture, office equipment and other assets, our corporate headquarters building and amortization of capitalized software and website development costs.

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Depreciation	\$82	\$79	\$69
% of revenue	5.1 %	5.1 %	4.7 %

Depreciation expense increased \$3 million and \$10 million during the years ended December 31, 2018 and 2017 when compared to the same periods in 2017 and 2016, respectively, primarily due to an increase in amortization related to capitalized software and website development costs.

## Amortization of Intangible Assets

Amortization consists of the amortization of definite-lived intangibles purchased in business acquisitions.

	Year ended December 31,		
	2018	2017	2016
	(in millions)		

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

Amortization of intangible assets	\$34	\$32	\$32
% of revenue	2.1 %	2.1 %	2.2 %

Amortization of intangible assets increased \$2 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to incremental amortization from purchased definite-lived intangibles related to a business acquisition during 2018. Refer to “Note 3: Acquisitions and Other Investments” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for additional information on our acquisitions. Amortization of intangible assets remained flat during the year ended December 31, 2017 when compared to the same period in 2016, as incremental amortization from purchased definite-lived intangibles related to business acquisitions in 2016 were offset due to the completion of amortization related to certain intangible assets from business acquisitions in prior periods.



## Interest Expense

Interest expense primarily consists of interest incurred, commitment fees and debt issuance cost amortization related to our 2015 Credit Facility, 2016 Credit Facility, and Chinese Credit Facilities, as well as interest on our financing obligation related to our corporate headquarters.

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Interest expense	\$(12)	\$(15)	\$(12)

Interest expense decreased \$3 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to lower average outstanding borrowings on our 2015 Credit Facility during the year ended December 31, 2018. Interest expense increased \$3 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to an increase in interest incurred related to higher average outstanding borrowings and effective interest rates during the year ended December 31, 2017, primarily on our 2015 Credit Facility. Refer to “Note 10: Debt” and “Note 14: Commitments and Contingencies” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for additional information on our borrowing facilities and our financing obligation related to our corporate headquarters building, respectively.

## Interest Income and Other, Net

Interest income and other, net primarily consists of interest earned from our money market funds and marketable securities, amortization of discounts and premiums on our marketable securities, net foreign exchange gains and losses, and gains and losses on sales of our marketable securities.

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Interest income and other, net	\$2	\$ 1	\$ (3 )

Interest income and other, net increased \$1 million during the year ended December 31, 2018 when compared to the same period in 2017, primarily due to an increase in interest income earned from our money market funds of \$6 million and a loss of \$2 million in 2017 related to our investment in a privately-held company which did not reoccur in 2018, partially offset by an increase of \$7 million in net foreign currency transaction losses as a result of the fluctuation of foreign exchange rates. Interest income and other, net increased \$4 million during the year ended December 31, 2017 when compared to the same period in 2016, primarily due to an increase of \$6 million in net foreign currency transaction gains, as a result of the fluctuation of foreign exchange rates, partially offset by a loss of \$2 million related to our investment in a privately-held company recognized during the year ended December 31, 2017, which did not occur in 2016.

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## Provision for Income Taxes

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Provision for income taxes	\$60	\$129	\$31
Effective income tax rate	34.7%	117.3%	20.5%

On December 22, 2017, the 2017 Tax Act was signed into United States tax law. The legislation significantly changed U.S. tax law by, among other provisions, lowering corporate income tax rates, and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The 2017 Tax Act permanently reduced the U.S. corporate income tax rate from 35% to 21%, effective January 1, 2018. Refer to “Note 11: Income Taxes” in the notes to our consolidated financial statements in Item 8 for further information on the financial statement impact of the 2017 Tax Act.

Our effective income tax rate is higher than the federal statutory rate in the United States primarily due to foreign valuation allowances, unrecognized tax benefits, and non-deductible stock based compensation. This is partially offset by international provisions from the 2017 Tax Act, and earnings in jurisdictions outside the United States, where our effective income tax rate is lower.

#### 2018 vs. 2017

Our effective income tax rate decreased to 34.7% during the year ended December 31, 2018 from 117.3% in the same period in 2017. The decrease in the effective tax rate for the year ended December 31, 2018 when compared to the same period in 2017, was primarily due to the Transition Tax and remeasurement of our deferred tax assets and liabilities as a result of the 2017 Tax Act recorded in 2017 and which did not reoccur in 2018, as well as the decrease in the U.S. corporate tax rate.

#### 2017 vs. 2016

Our effective income tax rate increased to 117.3% during the year ended December 31, 2017 from 20.5% in the same period in 2016. The change in the effective income tax rate for 2017 compared to the 2016 rate was primarily due to the Transition Tax and remeasurement of our deferred tax assets and liabilities as a result of the 2017 Tax Act, foreign valuation allowances, and non-deductible stock based compensation. We recorded an estimate of \$67 million of Transition Tax, and \$6 million due to a remeasurement of our net deferred tax assets, during the year ended December 31, 2017, which reflected provisional amounts for those specific income tax effects of the 2017 Tax Act, which did not occur in 2016.

#### Adjusted EBITDA

To provide investors with additional information regarding our financial results, we also disclose Adjusted EBITDA, which is a non-GAAP financial measure. A “non-GAAP financial measure” refers to a numerical measure of a company’s historical or future financial performance, financial position, or cash flows that excludes (or includes) amounts that are included in (or excluded from) the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles in the United States (“GAAP”) in such company’s financial statements.

Adjusted EBITDA is also our segment profit measure and a key measure used by our management and board of directors to understand and evaluate the operating performance of our business and on which internal budgets and forecasts are based and approved. In particular, the exclusion of certain expenses in calculating Adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Accordingly, we believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors. We define Adjusted EBITDA as net income (loss) plus: (1) provision for income taxes; (2) other income (expense), net; (3) depreciation of property and equipment, including amortization of internal use software and website development; (4) amortization of intangible assets; (5) stock-based compensation and other stock-settled obligations; (6) goodwill, long-lived asset and intangible asset impairments; (7) legal reserves and settlements; and (8) other non-recurring expenses and income. During the fourth quarter of 2018, the Company revised its Adjusted EBITDA definition to exclude legal reserves and settlements, as the Company believes these costs are not directly tied to the core operations of our business. The Company believes that excluding these amounts better enables management and investors to compare financial results between periods as these costs may vary independent of business performance. This revision to our definition did not have a material impact to Adjusted EBITDA for any period prior to the year ended December 31, 2018; therefore, no reclassifications have been made to conform the prior periods to the current period presentation. This revision had no effect on GAAP results in any period.

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Our use of Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results reported in accordance with GAAP. Because of these limitations, you should consider Adjusted EBITDA alongside other financial performance measures, including net income and our other GAAP results.

Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or cash requirements necessary to service interest or principal payments on our debt;
- Adjusted EBITDA does not consider the potentially dilutive impact of stock-based compensation or other stock-settled obligations;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- Adjusted EBITDA does not reflect certain income and expenses not directly tied to the core operations of our business, such as legal reserves and settlements;
- Adjusted EBITDA does not reflect tax payments that may represent a reduction in cash available to us; and
- Other companies, including companies in our own industry, may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

The following table presents a reconciliation of Adjusted EBITDA to Net Income, the most directly comparable financial measure calculated and presented in accordance with GAAP, for the periods presented:

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Net income (loss)	\$113	\$(19)	\$120
Add: Provision for income taxes	60	129	31
Add: Other expense (income), net	10	14	15
Add: Stock-based compensation	118	96	85
Add: Legal reserves and settlements	5	-	-
Add: Amortization of intangible assets	34	32	32
Add: Depreciation	82	79	69
Adjusted EBITDA	\$422	\$331	\$352

## Liquidity and Capital Resources

Our principal source of liquidity is cash flows generated from operations, although liquidity needs can also be met through drawdowns under our credit facilities. As of December 31, 2018 and 2017, we had \$670 million and \$735 million, respectively, of cash, cash equivalents and short and long-term available-for-sale marketable debt securities. As of December 31, 2018 approximately \$237 million of our cash and cash equivalents, and \$15 million of short-term available-for-sale marketable debt securities, were held by our international subsidiaries outside of the United States, with the majority in the United Kingdom. As of December 31, 2018 the significant majority of total cash on hand is denominated in U.S. dollars. Cumulative undistributed earnings of foreign subsidiaries totaled approximately \$651 million as of December 31, 2018. During the year ended December 31, 2018, we made a one-time repatriation of \$325

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million of foreign earnings to the United States primarily to repay our remaining outstanding debt under the 2015 Credit Facility. We intend to indefinitely reinvest the remaining foreign undistributed earnings although we will continue to evaluate the impact of the 2017 Tax Act on our capital deployment within and outside the U.S. Should we distribute, or be treated under certain U.S. tax rules as having distributed, the earnings of foreign subsidiaries in the form of dividends or otherwise, we may be subject to U.S.

income taxes or tax benefits. The amount of any unrecognized deferred income tax on this temporary difference is not material.

As of December 31, 2018, we had no outstanding borrowings and approximately \$1.2 billion of borrowing capacity available under our 2015 Credit Facility and approximately \$40 million of borrowing capacity available under our Chinese Credit Facilities. For further discussion on our credit facilities, see below, and also refer to “Note 10: Debt” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K.

#### 2015 Credit Facility

In June 2015, we entered into a five year credit agreement with a group of lenders which, among other things, provided for a \$1 billion unsecured revolving credit facility (the “2015 Credit Facility”). In May 2017, the 2015 Credit Facility was amended to, among other things, (i) increase the aggregate amount of revolving loan commitments available from \$1.0 billion to \$1.2 billion; and (ii) extend the maturity date of the 2015 Credit Facility from June 26, 2020 to May 12, 2022 (the “First Amendment”). Borrowings under the 2015 Credit Facility generally bear interest, at the Company’s option, at a rate per annum equal to either (i) the Eurocurrency Borrowing rate, or the adjusted LIBO rate for the interest period in effect for such borrowing; plus an applicable margin ranging from 1.25% to 2.00% (“Eurocurrency Spread”), based on the Company’s leverage ratio; or (ii) the Alternate Base Rate (“ABR”) Borrowing, which is the greatest of (a) the Prime Rate in effect on such day, (b) the New York Fed Bank Rate in effect on such day plus 1/2 of 1.00% per annum and (c) the Adjusted LIBO Rate (or LIBO rate multiplied by the Statutory Reserve Rate) for an interest period of one month plus 1.00%; in addition to an applicable margin ranging from 0.25% to 1.00% (“ABR Spread”), based on the Company’s leverage ratio. The Company may borrow from the 2015 Credit Facility in U.S. dollars, Euros and British pound.

As of December 31, 2018, we had no outstanding borrowings and approximately \$1.2 billion of borrowing capacity available under our 2015 Credit Facility. We are required to pay a quarterly commitment fee, at an applicable rate ranging from 0.15% to 0.30%, on the daily unused portion of the revolving credit facility for each fiscal quarter and additional fees in connection with the issuance of letters of credit. As of December 31, 2018, our unused revolver capacity was subject to a commitment fee of 0.15%, given the Company’s leverage ratio. The 2015 Credit Facility includes \$15 million of borrowing capacity available for letters of credit and \$40 million for Swingline borrowings on same-day notice.

The 2015 Credit Facility contains a number of covenants that, among other things, restrict our ability to: incur additional indebtedness, create liens, enter into sale and leaseback transactions, engage in mergers or consolidations, sell or transfer assets, pay dividends and distributions, make investments, loans or advances, prepay certain subordinated indebtedness, make certain acquisitions, engage in certain transactions with affiliates, amend material agreements governing certain subordinated indebtedness, and change our fiscal year. The 2015 Credit Facility also requires us to maintain a maximum leverage ratio and contains certain customary affirmative covenants and events of default, including a change of control. If an event of default occurs, the lenders under the 2015 Credit Facility will be entitled to take various actions, including the acceleration of all amounts due under the 2015 Credit Facility. As of December 31, 2018 and December 31, 2017, we were in compliance with all of our debt covenants.

#### 2016 Credit Facility

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We were party to an uncommitted facility agreement which provided for a \$73 million unsecured revolving credit facility (the “2016 Credit Facility”) with no specific expiration date. We initially borrowed \$73 million from this uncommitted credit facility in 2016 and repaid the full amount during the year ended December 31, 2017. These funds were used for general working capital needs of the Company, primarily for partial repayment of our 2015 Credit Facility. In June 2018, the Company terminated the 2016 Credit Facility and had no outstanding borrowings under the 2016 Credit Facility at the time of termination.

#### Chinese Credit Facilities

We are parties to a \$30 million, one-year revolving credit facility with Bank of America (the “Chinese Credit Facility—BOA”) that is currently subject to review on a periodic basis with no specific expiration period.



Borrowings under our Chinese Credit Facility—BOA generally bears interest at a rate based on People’s Bank of China benchmark, including certain adjustments which may be made in accordance with market conditions at the time of borrowing. As of December 31, 2018 there were no outstanding borrowings under our Chinese Credit Facility—BOA.

We are also parties to a RMB 70,000,000 (approximately \$10 million), one-year revolving credit facility with J.P. Morgan Chase Bank (“Chinese Credit Facility—JPM”). Our Chinese Credit Facility—JPM generally bears interest at a rate based on People’s Bank of China benchmark, including certain adjustments which may be made in accordance with market conditions at the time of borrowing. As of December 31, 2018, there were no outstanding borrowings under our Chinese Credit Facility—JPM.

On February 15, 2013, our Board of Directors authorized the repurchase of \$250 million of our shares of common stock under a share repurchase program. During the year ended December 31, 2016, we repurchased 2,002,356 shares of the Company’s outstanding common stock under this share repurchase program at an aggregate cost of \$105 million, and completed this share repurchase program. On January 25, 2017, our Board of Directors authorized the repurchase of \$250 million of our shares of common stock under another share repurchase program. During the year ended December 31, 2017, we repurchased a total of 6,079,003 shares of the Company’s outstanding common stock at an aggregate cost of \$250 million, and completed this share repurchase program.

On January 31, 2018, our Board of Directors authorized an additional repurchase of up to \$250 million of our shares of common stock under a share repurchase program. This share repurchase program has no expiration date but may be suspended or terminated by the Board of Directors at any time. During the year ended December 31, 2018, we repurchased 2,582,198 shares of the Company’s outstanding common stock at an aggregate cost of \$100 million. As of December 31, 2018, we had a remaining \$150 million available to repurchase shares of our common stock under this share repurchase program.

Our business experiences seasonal fluctuations that affect the timing of our annual cash flows related to working capital. In our Rentals free-to-list model and our Experiences offerings, we receive cash from travelers at the time of booking and we record these amounts, net of commissions, on our consolidated balance sheets as deferred merchant payables. We pay the suppliers, or the property rental owners and experience providers, after the travelers’ use. Therefore, we receive cash from the traveler prior to paying the supplier and this operating cycle represents a working capital source or use of cash to us. During the first half of the year Rentals and Experiences bookings typically exceed the amount of completed stays and tour-taking, resulting in higher cash flow related to working capital, while during the second half of the year, particularly in the third quarter, this pattern reverses and cash flows from these transactions are typically negative. While we expect the impact of seasonal fluctuations to continue, further significant shifts in our business mix or adverse economic conditions could result in future seasonal patterns that are different from historical trends.

We believe that our available cash, cash equivalents and marketable securities, combined with expected cash flows generated by operating activities and available borrowings from our credit facilities, will be sufficient to fund our foreseeable working capital requirements, capital expenditures, existing business growth initiatives, debt obligations, lease commitments, and other financial commitments through at least the next twelve months. Our future capital requirements may also include capital needs for acquisitions, share repurchases, and/or other expenditures in support of our business strategy, thus may potentially reduce our cash balance and/or increase our debt.

Our cash flows from operating, investing and financing activities, as reflected in our consolidated statements of cash flows, are summarized in the following table:

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Net cash provided by (used in):			
Operating activities	\$405	\$238	\$321
Investing activities	(49)	6	(163)
Financing activities	(358)	(200)	(143)

During the year ended December 31, 2018, our primary use of cash was in operations, financing activities, including the repayment of combined outstanding borrowings under the 2015 Credit Facility and Chinese Credit Facilities of \$245 million, repurchases of our outstanding common stock at an aggregate cost of \$100 million under our existing share repurchase program, and investing activities, including capital expenditures incurred during the year of \$61 million and business acquisitions and other investing activities of \$36 million. This use of cash was funded primarily with cash on hand and cash equivalents, which included a one-time cash repatriation \$325 million of foreign earnings to the United States, cash provided by operations, and investing activities, including net cash generated of \$48 million from purchases, sales and maturities of marketable securities.

During the year ended December 31, 2017, our primary use of cash was in operations, financing activities, including the repayment of borrowings under the 2015 Credit Facility of \$296 million, repurchases of our outstanding common stock at an aggregate cost of \$250 million under a share repurchase program, repayment of outstanding borrowings under the 2016 Credit Facility of \$73 million, and investing activities, including capital expenditures incurred during the year of \$64 million. This use of cash was funded primarily with cash on hand and cash equivalents, cash provided by operations, financing activities, including additional net borrowings of \$433 million under the 2015 Credit Facility, and investing activities, including net cash generated of \$70 million from purchases, sales and maturities of marketable securities.

During the year ended December 31, 2016, our primary use of cash was in operations, and financing activities, including the repayment of borrowings under our 2015 Credit Facility of \$210 million, repurchases of our outstanding common stock at an aggregate cost of \$105 million under a share repurchase program, and investing activities, including capital expenditures incurred during the year of \$72 million and net cash used of a \$50 million in purchases, sales and maturities of marketable securities, and business acquisitions and other investments of \$43 million. This use of cash was funded primarily with cash on hand and cash equivalents, cash provided by operations, and financing activities, including additional borrowings of \$101 million under the 2015 Credit Facility and \$73 million under the 2016 Credit Facility.

For the year ended December 31, 2018, net cash provided by operating activities increased by \$167 million or 70% when compared to the same period in 2017, primarily due to an increase in net income of \$132 million and an increase in net working capital movements of \$35 million, primarily due to the timing of collection of customer receivables, vendor payments, and income tax payments. For the year ended December 31, 2017, net cash provided by operating activities decreased by \$83 million or 26% when compared to the same period in 2016, primarily due to a decrease in net income of \$139 million and a decrease in net working capital movements of \$14 million, partially offset by an increase in non-cash items affecting cash flow of \$70 million which is primarily due to an increase in the following items: deferred tax expenses; stock-based compensation; and depreciation. The decrease in working capital movements of \$14 million was primarily due to the timing of collection of customer receivables, vendor payments, income tax payments, and deferred merchant payments.

For the year ended December 31, 2018, net cash provided by investing activities decreased by \$55 million when compared to the same period in 2017, primarily due to a decrease in net cash generated from the purchases, sales and maturities of our marketable securities of \$22 million, and an increase in cash paid for business acquisitions and other

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investing activities of \$36 million during year ended December 31, 2018. For the year ended December 31, 2017, net cash provided by investing activities increased by \$169 million when compared to the same period in 2016, primarily due to an increase in net cash provided from the purchases, sales and maturities of our marketable securities of \$120 million, a decrease in cash paid for business acquisitions and other investments of \$43 million, and a decrease in capital expenditures of \$8 million.

For the year ended December 31, 2018, net cash used in financing activities increased by \$158 million when compared to the same period in 2017, primarily due to a net repayment on our 2015 Credit Facility of \$230 million during the year ended December 31, 2018, compared to a net borrowing of \$137 million during the year ended December 31, 2017, partially offset by a decrease of \$150 million in cash used to purchase shares of our common stock under our share repurchase programs in 2018, as discussed above, as well as the repayment of our 2016 Credit Facility borrowings of \$73 million during the year ended December 31, 2017, which did not reoccur in 2018. For the year ended December 31, 2017, net cash used in financing activities increased by \$57 million when compared to the same period in 2016, primarily due to an increase of \$145 million in cash used in 2017 to purchase shares of our common stock under our share repurchase programs in 2017, as discussed above, as well as a net new borrowing on

our 2016 Credit Facility of \$73 million in 2016 which was subsequently repaid in 2017, partially offset by an increase in net borrowings under our 2015 Credit Facility of \$246 million for the year ended December 31, 2017 when compared to the same period in 2016.

The following table summarizes our material contractual obligations and commercial commitments as of December 31, 2018:

	By Period				
	Less than				More than
	1				
	Total	year	1 to 3 years	3 to 5 years	5 years
	(in millions)				
Property leases, net of sublease income (1)	\$193	\$25	\$ 49	\$ 43	\$ 76
2017 Tax Act - Transition tax liability	31	-	-	4	27
Expected commitment fee payments on 2015 Credit Facility (2)	6	2	3	1	-
Purchase obligations and other (3)	19	7	8	3	1
Total (4),(5)	\$249	\$34	\$ 60	\$ 51	\$ 104

- (1) Estimated future minimum rental payments under operating leases with non-cancelable lease terms, including our corporate headquarters lease in Needham, MA. Refer to “Office Lease Commitments” discussion below.
- (2) Expected commitment fee payments are based on the daily unused portion of the 2015 Credit Facility, issued letters of credit, and the effective commitment fee rate as of December 31, 2018; however, these variables could change significantly in the future.
- (3) Estimated purchase obligations that are fixed and determinable are primarily related to telecommunication and licensing contracts, with various expiration dates through approximately December 2024. These contracts have non-cancelable terms or are cancelable only upon payment of significant penalty.
- (4) Excluded from the table was \$148 million of unrecognized tax benefits, including interest, that we have recorded in other long-term liabilities for which we cannot make a reasonably reliable estimate of the amount and period of payment. We do not anticipate any material changes in the next year. Refer to “Note 11: Income Taxes” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further discussion.
- (5) Excluded from the table was \$3 million of undrawn standby letters of credit, primarily related to our property leases.

#### Office Lease Commitments

In June 2013 we entered into a lease for a new corporate headquarters building (“Headquarters Lease”). Pursuant to the Headquarters Lease, the landlord built an approximately 280,000 square foot rental building in Needham, Massachusetts (the “Premises”), and leased the Premises to the Company as our corporate headquarters for an initial term of 15 years and 7 months or through December 2030. The Company also has an option to extend the term of the Headquarters Lease for two consecutive terms of five years each.

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Because we were involved in the construction project and were responsible for paying a significant portion of the costs of normal finish work and structural elements of the Premises, the Company was deemed for accounting purposes to be the owner of the Premises during the construction period under build to suit lease accounting guidance under GAAP. Therefore, the Company recorded project construction costs during the construction period incurred by the landlord as a construction-in-progress asset and a related construction financing obligation on our consolidated balance sheets. The amounts that the Company has paid or incurred for normal tenant improvements and structural improvements had also been recorded to the construction-in-progress asset.

Upon completion of construction at end of the second quarter of 2015, we evaluated the construction-in-progress asset and construction financing obligation for de-recognition under the criteria for “sale-leaseback” treatment under GAAP. We concluded that we have forms of continued economic involvement in the facility, and therefore did not meet the provisions for sale-leaseback accounting. This determination was based on the Company's continuing involvement with the property in the form of non-recourse financing to the lessor. Therefore, the Headquarters Lease is accounted for as a financing obligation. Accordingly, we began depreciating the building asset over its estimated useful life and incurring interest expense related to the financing obligation imputed using the effective interest rate method. We bifurcate our lease payments pursuant to the Premises into: (i) a portion that is allocated to the building (a reduction to the financing obligation) and; (ii) a portion that is allocated to the land on which the building was constructed. The portion of the lease obligations allocated to the land is treated as an operating lease that commenced in 2013. The lease costs allocated to the land are recognized as rent expense on a straight-line basis over the term of the lease and are recorded in general and administrative expense in the consolidated statements of operations. The financing obligation is considered a long-term finance lease obligation and is recorded to other long-term liabilities on our consolidated balance sheet. In the years ended December 31, 2018, 2017 and 2016, the Company recorded \$7 million of interest expense in each year, respectively, \$3 million of depreciation expense in each year, respectively, and \$2 million of rent expense in each year, in general and administrative expense, respectively, on our consolidated statements of operations related to the Premises.

We also lease an aggregate of approximately 450,000 square feet of office space at approximately 40 other locations across North America, Europe and Asia Pacific in cities such as, New York, Boston, London, Sydney, Barcelona, Paris, and Beijing, primarily for our sales offices, subsidiary headquarters, and international management teams, pursuant to leases with various expiration dates, with the latest expiring in June 2027.

As of December 31, 2018, future minimum commitments under our Headquarters Lease and other non-cancelable operating leases for office space with terms of more than one year and contractual sublease income were as follows:

Year	Corporate Headquarters			Total Lease Commitments (Net of Sublease Income)	
	Lease (1)	Operating Leases	Sublease Income		
	(in millions)				
2019	\$ 9	\$ 19	\$ (3 )	\$ 25	
2020	9	18	(2 )	25	
2021	10	16	(2 )	24	
2022	10	16	(2 )	24	
2023	10	9	—	19	
Thereafter	67	9	—	76	
Total	\$ 115	\$ 87	\$ (9 )	\$ 193	

(1) Amount includes an \$83 million financing obligation, which we have recorded in other long-term liabilities on our consolidated balance sheet at December 31, 2018, related to our Headquarters Lease.

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The Financial Accounting Standards Board (“FASB”) issued new lease accounting guidance under ASC 842, Leases, which the Company will adopt on January 1, 2019. Upon adoption, we expect our Headquarters Lease to be classified and accounted for as a finance lease under the new accounting guidance, rather than as a financing obligation under the existing GAAP. Upon adoption of the new guidance, we expect to derecognize amounts in property and equipment, net and other long-term liabilities on our consolidated balance sheet as of December 31, 2018 related to our Headquarters Lease of approximately \$62 million and \$70 million, respectively, with the difference recorded to our opening balance of retained earnings as of the adoption date. Accordingly, we expect to then recognize a right-of-use (ROU) asset ranging from \$105 million to \$120 million and a lease liability of approximately \$85 million to \$95 million based on the initial measurement of the present value of the remaining lease payments over the remaining lease term. The difference between the ROU asset and lease liability relates to a net prepaid rent balance. We expect our office space leases, except for our Headquarters Lease, to remain operating



leases under the new guidance, which we will recognize ROU assets and corresponding lease liabilities on our consolidated balance sheet under the new guidance. We expect to recognize ROU assets ranging from \$70 million to \$80 million and lease liabilities of approximately \$85 million to \$95 million based on the present value of the remaining rental payments for these office leases as of January 1, 2019. The difference in the ROU asset and the lease liability is the result of balances already recognized related to deferred and prepaid rent balances. We do not expect the adoption of this new guidance will have a material impact, either on an annual or quarterly basis, to our consolidated statement of operations, including operating income, net income and adjusted EBITDA, as well as to our consolidated statement of cash flows on a go-forward basis. Refer to “Note 2: Significant Accounting Policies” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further discussion regarding the new lease accounting guidance and its expected impact of adoption to our consolidated financial statements and related disclosures.

#### Off-Balance Sheet Arrangements

As of December 31, 2018, other than the items discussed above, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have, or are reasonably likely to have, a current or future effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

#### Contingencies

In the ordinary course of business, we are parties to regulatory and legal matters, including threats thereof, arising out of our operations. These matters may involve claims involving patent and intellectual property rights (including alleged infringement of third-party intellectual property rights), tax matters (including value-added, excise, transient occupancy and accommodation taxes), regulatory compliance (including competition and consumer matters), defamation and other claims. Periodically, we review the status of all significant outstanding matters to assess any potential financial exposure. When (i) it is probable that an asset has been impaired or a liability has been incurred; and (ii) the amount of the loss can be reasonably estimated, we record the estimated loss in our consolidated statements of operations. We provide disclosures in the notes to the consolidated financial statements for loss contingencies that do not meet both of these conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the consolidated financial statements. We base accruals on the best information available at the time which can be highly subjective. Although occasional adverse decisions or settlements may occur, we do not believe that the final disposition of any of these matters will have a material adverse effect on our business. However, the final outcome of these matters could vary significantly from our estimates. Finally, there may be claims or actions pending or threatened against us of which we are currently not aware and the ultimate disposition of which could have a material adverse effect on us.

On December 22, 2017, the Securities and Exchange Commission issued SAB 118, which allowed us to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. Accordingly, we recorded an estimate of \$67 million of Transition Tax, and \$6 million due to a remeasurement of our net deferred tax assets, during the year ended December 31, 2017, which reflected provisional amounts for those specific income tax effects of the 2017 Tax Act. December 22, 2018 marked the end of the measurement period for the purposes of SAB 118. During the measurement period, impacts of the law were recorded at the time a reasonable estimate for all or a portion of the effects were made, and provisional amounts were recognized and adjusted as information became available, prepared, or analyzed. As permitted under SAB 118, we have subsequently finalized our accounting analysis based on the guidance, interpretations, and data available as of December 31, 2018. During the year ended December 31, 2018, we recorded a \$2 million income tax expense related to the Transition Tax, which reflects additional information that we obtained during 2018 related to uncertain tax positions, earnings and profits, foreign tax credits, and state taxes. We also recorded a \$2 million benefit related to the adjustment of deferred taxes based on

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the tax rate that is expected to apply when such deferred taxes are settled or realized in future periods.

We are also under audit by the IRS and various other domestic and foreign tax authorities with regards to income tax matters. We have reserved for potential adjustments to our provision for income taxes that may result from examinations by, or any negotiated agreements with, these tax authorities. Although we believe our tax

estimates are reasonable, the final determination of audits could be materially different from our historical income tax provisions and accruals. The results of an audit could have a material effect on our financial position, results of operations, or cash flows in the period for which that determination is made.

By virtue of consolidated income tax returns previously filed with Expedia, we are currently under an IRS audit for the 2009, 2010, and short-period 2011 tax years, and have various ongoing state income tax audits. We are separately under examination by the IRS for the short-period 2011, 2012 and 2013 tax years and under an employment tax audit with the IRS for the 2013 and 2014 tax years. These audits include questioning of the timing and the amount of income and deductions and the allocation of income among various tax jurisdictions. These examinations may lead to proposed or ordinary course adjustments to our taxes. We are no longer subject to tax examinations by tax authorities for years prior to 2009. As of December 31, 2018, no material assessments have resulted, except as noted below regarding our 2009 and 2010 IRS audit with Expedia.

In January 2017, as part of the IRS audit of Expedia, we received Notices of Proposed Adjustment from the IRS for the 2009 and 2010 tax years. These proposed adjustments are related to certain transfer pricing arrangements with our foreign subsidiaries, and would result in an increase to our worldwide income tax expense in an estimated range of \$10 million to \$14 million after consideration of competent authority relief, exclusive of interest and penalties. We disagree with the proposed adjustments and intend to defend our position through applicable administrative and, if necessary, judicial remedies. Our policy is to review and update tax reserves as facts and circumstances change. Based on our interpretation of the regulations and available case law, we believe the position we have taken with regard to transfer pricing with our foreign subsidiaries is sustainable. In addition to the risk of additional tax for 2009 and 2010 transactions, if the IRS were to seek transfer pricing adjustments of a similar nature for transactions in subsequent years, we would be subject to significant additional tax liabilities.

In July 2015, the United States Tax Court (the “Court”) issued an opinion favorable to Altera Corporation (“Altera”) with respect to Altera’s litigation with the IRS. This opinion was submitted as a final decision under Tax Court Rule 155 during December 2015. The litigation relates to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera’s foreign subsidiary. In its opinion, the Court accepted Altera’s position of excluding stock based compensation from its inter-company cost-sharing arrangement. The IRS appealed the Court decision on February 19, 2016. At this time, the U.S. Department of the Treasury has not withdrawn the requirement from its regulations to include stock-based compensation in intercompany cost-sharing arrangements. The Company recorded a tax benefit of \$3 million, \$5 million and \$6 million in its consolidated statements of operations for the years ended December 31, 2018, 2017 and 2016, respectively. Since the Court’s 2015 opinion, the Company has taken total income tax benefits of \$15 million as of December 31, 2018. On July 24, 2018, the IRS won the appeals court case at the Ninth Circuit; however, on August 7, 2018, the Ninth Circuit withdrew its decision regarding Altera and the case was reheard. While we have taken an income tax benefit based on the Court’s 2015 opinion, as discussed above, we will continue to review the latest decisions on the case and its impact to our consolidated financial statements.

Additionally, we continue to accumulate positive cash flows in foreign jurisdictions, which we consider indefinitely reinvested, although we will continue to evaluate the impact of the 2017 Tax Act on our capital deployment within and outside the U.S. Should we distribute, or be treated under certain U.S. tax rules as having distributed, the earnings of foreign subsidiaries in the form of dividends or otherwise, we may be subject to U.S. income taxes or tax benefits. The amount of any unrecognized deferred income tax on this temporary difference is not material.

Refer to “Note 11: Income Taxes” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further information on the impact of the 2017 Tax Act, potential contingencies surrounding current audits by the IRS and various other domestic and foreign tax authorities, and other income tax matters.

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## Certain Relationships and Related Party Transactions

For information on our relationships with LTRIP and Expedia refer to “Note 17: Related Party Transactions” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K.

## Critical Accounting Policies and Estimates

Critical accounting policies and estimates are those that we believe are important in the preparation of our consolidated financial statements because they require that management use judgment and estimates in applying those policies. We prepare our consolidated financial statements and accompanying notes in accordance with GAAP. Preparation of the consolidated financial statements and accompanying notes requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements as well as revenue and expenses during the periods reported. Management bases its estimates on historical experience, when applicable and other assumptions that it believes are reasonable under the circumstances. Actual results may differ from estimates under different assumptions or conditions.

There are certain critical estimates that we believe require significant judgment in the preparation of our consolidated financial statements. We consider an accounting estimate to be critical if:

It requires us to make an assumption because information was not available at the time or it included matters that were highly uncertain at the time we were making the estimate; and/or

- Changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

Refer to “Note 2: Significant Accounting Policies” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for an overview of our significant accounting policies and new accounting pronouncements that we have adopted or that we plan to adopt that have had or may have an impact on our financial statements.

A discussion of information about the nature and rationale for our critical accounting estimates is below.

### Recognition and Recoverability of Goodwill, Definite-Lived Intangibles, and Other Long-Term Assets

We account for acquired businesses using the acquisition method of accounting which requires that the tangible assets and identifiable intangible assets acquired and assumed liabilities be recorded at the date of acquisition at their respective fair values. Any excess purchase price over the estimated fair value of the net tangible and intangible assets acquired is allocated to goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets. Significant estimates in valuing certain intangible assets include but are not limited to future expected cash flows from customer and supplier relationships, acquired technology and trade names from a market participant perspective, useful lives and discount rates. Management’s estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Valuations are performed by management or third party valuation specialists under management's supervision, where appropriate.

We assess goodwill, which is not amortized, for impairment annually during the fourth quarter, or more frequently, if events and circumstances indicate impairment may have occurred. We test goodwill for impairment at the reporting

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unit level. Goodwill is assigned to reporting units that are expected to benefit from the synergies of the business combination as of the acquisition date. We evaluate our reporting units when changes in our operating structure occur, and if necessary, reassign goodwill using a relative fair value allocation approach. Once goodwill has been allocated to the reporting units, it no longer retains its identification with a particular acquisition and becomes identified with the reporting unit in its entirety. Accordingly, the fair value of the reporting unit as a whole is available to support the recoverability of its goodwill.

The Company has the option to qualitatively assess whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. In the evaluation of goodwill for impairment, we generally first perform a qualitative assessment to determine whether it is more likely than not (i.e., a likelihood of more than 50%) that the estimated fair value of the reporting unit is less than the carrying amount. Periodically, we may choose to forgo the initial qualitative assessment and proceed directly to a quantitative analysis to assist in our annual evaluation. When assessing goodwill for impairment, our decision to perform a qualitative impairment assessment for an individual reporting unit in a given year is influenced by a number of factors, including, but not limited to, the size of the

reporting unit's goodwill, the significance of the excess of the reporting unit's estimated fair value over carrying value at the last quantitative assessment date, the amount of time in between quantitative fair value assessments from the date of acquisition to establish an updated baseline quantitative analysis, and other performance and market indicators. During a qualitative assessment, if we determine that it is not more likely than not that the implied fair value of the goodwill is less than its carrying amount, no further testing is necessary. If, however, we determine that it is more likely than not that the implied fair value of the goodwill is less than its carrying amount, we then perform a quantitative assessment and compare the estimated fair value of the reporting unit to the carrying value. If the carrying value of a reporting unit exceeds its estimated fair value, the goodwill impairment is measured using the difference between the carrying value and the fair value of the reporting unit; however, any loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit.

In determining the estimated fair values of reporting units in a quantitative goodwill impairment test, we generally use a blend, of the following recognized valuation methods: the income approach (discounted cash flows model) and the market valuation approach, which we believe compensates for the inherent risks of using either model on a stand-alone basis. The discounted cash flows model indicates the fair value of the reporting units based on the present value of the cash flows that we expect the reporting units to generate in the future. Our significant estimates in the discounted cash flows model include: weighted average cost of capital; long-term rate of growth and profitability of the reporting unit; income tax rates and working capital effects. The market valuation approach indicates the fair value of the business based on a comparison to comparable publicly traded firms in similar lines of business and other precedent transactions. Our significant estimates in the market approach model include identifying similar companies with comparable business factors such as size, growth, profitability, risk and return on investment and assessing comparable revenue and/or income multiples in estimating the fair value of the reporting units. Valuations are performed by management or third party valuation specialists under management's supervision, where appropriate. We believe that the estimated fair values assigned to our reporting units in impairment tests are based on reasonable assumptions that marketplace participants would use. However, such assumptions are inherently uncertain and actual results could differ from those estimates. The use of different assumptions, estimates or judgments could trigger the need for an impairment charge, or materially increase or decrease the amount of any such impairment charge.

During the Company's annual goodwill impairment test during the fourth quarter of 2018, a qualitative assessment for each of our reporting units' goodwill was performed and we concluded it was not more likely than not that an impairment existed. Accordingly, we did not proceed to a quantitative assessment or recognize any impairment charges during the year ending December 31, 2018. As part of our qualitative assessment for our 2018 goodwill impairment analysis of our reporting units, the factors that we considered included, but were not limited to: (a) changes in macroeconomic conditions in the overall economy and the specific markets in which we operate, (b) our ability to access capital, (c) changes in the online travel industry, (d) changes in the level of competition, (e) evaluation of current and future forecasted financial results of the reporting units, (f) comparison of our current financial performance to historical and budgeted results of the reporting units, (g) change in excess of the Company's market capitalization over its book value, (h) changes in estimates, valuation inputs, and/or assumptions since the last quantitative analysis of the reporting units, (i) changes in the regulatory environment; (j) changes in strategic outlook or organizational structure and leadership of the reporting units; and (k) other relevant factors, and how these factors might impact specific performance in future periods. However, as we periodically reassess estimated future cash flows and asset fair values, changes in our estimates and assumptions may cause us to realize material impairment charges in the future.

We also periodically review the carrying amount of our definite-lived intangible assets and other long-term assets, including property and equipment and website and internal use software, to determine whether current events or circumstances indicate that such carrying amounts may not be recoverable. Factors that would necessitate an impairment assessment include a significant adverse change in the extent or manner in which an asset is used, a significant adverse change in legal factors or the business climate that could affect the value of the asset, or a

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significant decline in the observable market value of an asset, among others. If such facts indicate a potential impairment, we assess the recoverability of the asset group by determining if the carrying value of the asset group exceeds the sum of the projected undiscounted cash flows expected to result from the use and eventual disposition of the assets over the remaining economic life of the primary asset of the group. If the recoverability test indicates that the carrying value of the asset group is not recoverable, we will estimate the fair value of the asset group using appropriate valuation methodologies which would typically include an estimate of discounted cash flows, using an appropriate discount rate. Any impairment would be measured by the amount that the carrying values, of such asset



groups, exceed their fair value and would be included in operating income on the consolidated statement of operations. Considerable management judgment is necessary to estimate the fair value of asset groups. Accordingly, actual results could vary significantly from such estimates. We have not identified any circumstances that would warrant an impairment charge for any recorded definite-lived intangibles or other long term assets on our consolidated balance sheet at December 31, 2018.

## Income Taxes

We record income taxes under the asset and liability method. Deferred tax assets and liabilities reflect our estimation of the future tax consequences of temporary differences between the carrying amounts of assets and liabilities for book and tax purposes. We determine deferred income taxes based on the differences in accounting methods and timing between financial statement and income tax reporting. Accordingly, we determine the deferred tax asset or liability for each temporary difference based on the enacted income tax rates expected to be in effect when we realize the underlying items of income and expense. We consider all relevant factors when assessing the likelihood of future realization of our deferred tax assets, including our recent earnings experience by jurisdiction, expectations of future taxable income and the carryforward periods available to us for tax reporting purposes, as well as assessing available tax planning strategies. We may establish a valuation allowance to reduce deferred tax assets to the amount we believe is more likely than not to be realized. We classify deferred tax assets and liabilities as noncurrent on our consolidated balance sheet. Due to inherent complexities arising from the nature of our businesses, future changes in income tax law, tax sharing agreements or variances between our actual and anticipated operating results, we make certain judgments and estimates. Therefore, actual income taxes could materially vary from these estimates.

We record liabilities to address uncertain tax positions we have taken in previously filed tax returns or that we expect to take in a future tax return. The determination for required liabilities is based upon an analysis of each individual tax position, taking into consideration whether it is more likely than not that our tax position, based on technical merits, will be sustained upon examination. For those positions for which we conclude it is more likely than not it will be sustained, we recognize the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the taxing authority. The difference between the amount recognized and the total tax position is recorded as a liability. The ultimate resolution of these tax positions may be greater or less than the liabilities recorded.

On December 22, 2017, the 2017 Tax Act was signed into United States tax law. The legislation significantly changed U.S. tax law by, among other provisions, lowering corporate income tax rates, and imposing Transition Tax. The 2017 Tax Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018. The 2017 Tax Act also provided for prospective changes that began in 2018. Under GAAP, the effects of changes in income tax rates and laws are recognized in the period in which the new legislation is enacted.

We are subject to additional requirements of the 2017 Tax Act which began during the year ended December 31, 2018. Those provisions include a deduction for foreign derived intangible income ("FDII"), GILTI, a limitation of certain executive compensation, and other immaterial provisions. We have elected to account for GILTI as a period cost, and therefore included GILTI expense in the effective income tax rate calculation. Our 2018 effective income tax rate includes our estimates of these new provisions, with a net tax benefit of \$5 million recorded during the year ended December 31, 2018. Our estimates may be revised in future periods as we obtain additional data, and as the IRS issues new guidance implementing the law changes.

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Refer to “Note 11: Income Taxes” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further information on income taxes.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

### Market Risk Management

Market risk refers to the risk of loss arising from adverse changes in stock prices, interest rates and foreign currency exchange rates. We are exposed to market risks primarily due to our international operations, and our ongoing investing and financial activities. The risk of loss can be assessed from the perspective of adverse changes in our future earnings, cash flows, fair values, and financial condition. Our exposure to market risk includes our credit facilities, derivative instruments, cash, cash equivalents, short term and long term marketable securities, accounts receivable, intercompany receivables/payables, accounts payable and deferred merchant payables denominated in foreign currencies. We have established policies, procedures and internal processes governing our management of market risks and the use of financial instruments to manage and attempt to mitigate our exposure to such risks.

### Interest Rates

As of December 31, 2018, our primary exposure to changes in interest rates relates primarily to our investment portfolio. Changes in interest rates affect the amount of interest earned on our cash, cash equivalents, and marketable securities, and the fair value of those securities. Our interest income and expense is most sensitive to fluctuations in U.S. interest rates and Libor.

We currently invest our excess cash in cash deposits at major global banks, money market funds, and marketable securities. Our investment policy and strategy are focused on preservation of capital and supporting our liquidity requirements. We invest in highly-rated securities, and our investment policy limits the amount of credit exposure to any one issuer. Our investment policy requires our investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss.

In order 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 current investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on our investment positions as of December 31, 2018, a hypothetical 100 basis point increase in interest rates across all maturities would not result in a material decline in the fair value of the portfolio. In addition, such losses would only be realized if we sold the investments prior to maturity. Refer to “Note 7: Financial Instruments and Fair Value Measurements” in the notes to our consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further information on our investment portfolio and other financial instruments. As of December 31, 2018, we had no outstanding borrowings under our 2015 Credit Facility.

We currently do not hedge our interest rate risk; however, we are continually evaluating the interest rate market, and if we become increasingly exposed to potentially volatile movements in interest rates, and if these movements are material, this could cause us to adjust our financing strategy. We did not experience any material financial impact from changes in interest rates for the years ended December 31, 2018, 2017 or 2016.

### Foreign Currency Exchange Rates

We conduct business in certain international markets, primarily the European Union, including the United Kingdom, and also Singapore and Australia. Because we operate in international markets, we have exposure to different economic climates, political arenas, tax systems and regulations that could affect foreign currency exchange rates.

Some of our subsidiaries maintain their accounting records in their respective local currencies other than the U.S. dollar. Consequently, changes in foreign currency exchange rates may impact the translation of those subsidiary's financial statements into U.S. dollars. As a result, we face exposure to adverse movements in foreign currency

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exchange rates as the financial results of our non-U.S. dollar operations are translated from local currency, or functional currency, into U.S. dollars upon consolidation. If the U.S. dollar weakens against the functional currency, the translation of these foreign-currency-denominated balances will result in increased net assets, revenue, operating expenses, operating income and net income. Similarly, our net assets, revenue, operating expenses,

operating income and net income will decrease if the U.S. dollar strengthens against the functional currency. The effect of foreign currency exchange on our business historically has varied from quarter to quarter and may continue to do so, potentially materially. In order to provide a meaningful assessment of the foreign currency exchange rate risk associated with our consolidated financial statements, we performed a sensitivity analysis. A hypothetical 10% decrease of the foreign currency exchange rates relative to the U.S. dollar, or strengthening of the U.S. dollar, would generate an unrealized loss of approximately \$27 million related to a decrease in our net assets as of December 31, 2018, which would initially be recorded to accumulated other comprehensive income (loss) on our consolidated balance sheet.

In addition, foreign currency exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in transactional gains and losses. We recognize these transactional gains and losses (primarily Euro currency transactions) in our consolidated statements of operations and have recorded a foreign currency exchange loss of \$6 million for the year ended December 31, 2018, gain of \$1 million for the year ended December 31, 2017, and a loss of \$6 million for the year ended December 31, 2016, respectively, in “Interest income and other, net” on our consolidated statements of operations. Future transactional gains and losses are inherently difficult to predict as they are reliant on how the multiple currencies in which we transact fluctuate in relation to the U.S. dollar and other functional currencies, and the relative composition and denomination of monetary assets and liabilities each period.

We currently manage our exposure to foreign currency risk through internally established policies and procedures. To the extent practicable, we minimize our foreign currency exposures by maintaining natural hedges between our current assets and current liabilities in similarly denominated foreign currencies, as well as, using derivative financial instruments. We use foreign currency forward exchange contracts to manage certain short-term foreign currency risk to try and reduce the effects of fluctuating foreign currency exchange rates on our cash flows denominated in foreign currencies. We do not use financial instruments for trading purposes and are not a party to any leveraged derivatives. Our objective is to hedge only those foreign currency exposures that can be confidently identified and quantified and that may result in significant impacts to our cash or the consolidated statement of operations. Our policy does not allow speculation in derivative instruments for profit or execution of derivative instrument contracts for which there are no underlying exposures.

Our foreign currency forward exchange contracts, to date, have principally addressed foreign currency exchange fluctuation risk between the Euro and the U.S. dollar. We have accounted for our derivative instruments to date, which have not been designated as hedges under GAAP, as either assets or liabilities and carry them at fair value. We had two outstanding forward currency contracts as of December 31, 2018 with a total notional value of \$13 million. These outstanding forward currency contracts were not designated as hedges and had maturities of less than 90 days. We had no outstanding derivative contracts as of December 31, 2017. We recognize gains and losses from our derivative contracts in our consolidated statement of operations and have recorded net losses of \$3 million and \$1 million for the years ended December 31, 2018 and 2017, respectively, and a net gain of \$2 million for the year ended December 31, 2016, in “Interest income and other, net” on our consolidated statements of operations. Refer to “Note 7: Financial Instruments and Fair Value Measurements” in the notes to the consolidated financial statements in Item 8 on this Annual Report on Form 10-K for further detail on our derivative instruments.

As we increase our operations in international markets, our exposure to potentially volatile movements in foreign currency exchange rates increases. The economic impact to us of foreign currency exchange rate movements is linked to variability in real growth, inflation, interest rates, governmental actions, and other factors. These changes, if material, could cause us to adjust our foreign currency risk strategies. For example, Brexit has caused significant volatility in currency exchange rates, especially between the U.S. dollar and the British pound. Continued uncertainty regarding Brexit may result in future exchange rate volatility. Since the terms of the United Kingdom’s exit from the European Union are uncertain, we are unable to predict the effect Brexit will have on our business and results of

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operations related to foreign currency and other market risks.

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and board of directors

TripAdvisor, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of TripAdvisor, Inc. and subsidiaries (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders’ equity, and cash flows for each of the years in the three year period ended December 31, 2018, and the related notes (collectively, “the consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 22, 2019 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP



We have served as the Company's auditor since 2014.

Boston, Massachusetts

February 22, 2019

TRIPADVISOR, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

	Year ended December 31,		
	2018	2017	2016
Revenue (Note 4)	\$1,615	\$1,556	\$1,480
Costs and expenses:			
Cost of revenue (1)(2)	86	72	71
Selling and marketing (2)	778	849	756
Technology and content (2)	275	243	243
General and administrative (2)	177	157	143
Depreciation	82	79	69
Amortization of intangible assets	34	32	32
Total costs and expenses	1,432	1,432	1,314
Operating income	183	124	166
Other income (expense):			
Interest expense	(12 )	(15 )	(12 )
Interest income and other, net (Note 19)	2	1	(3 )
Total other income (expense), net	(10 )	(14 )	(15 )
Income before income taxes	173	110	151
Provision for income taxes (Note 11)	(60 )	(129 )	(31 )
Net income (loss)	\$113	\$(19 )	\$120
Earnings (loss) per share attributable to common stockholders			
(Note 5):			
Basic	\$0.82	\$(0.14 )	\$0.83
Diluted	\$0.81	\$(0.14 )	\$0.82
Weighted average common shares outstanding (Note 5):			
Basic	138	140	145
Diluted	140	140	147
(1) Excludes amortization expense as follows:			
Amortization of acquired technology included in			
amortization of intangible assets	\$8	\$8	\$7
Amortization of website development costs included in			
depreciation	59	54	46
	\$67	\$62	\$53
(2) Includes stock-based compensation expense as follows (Note 6):			
Cost of revenue	\$1	\$-	\$-
Selling and marketing	\$21	\$21	\$20
Technology and content	\$51	\$40	\$40

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

General and administrative	\$45	\$35	\$25
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The accompanying notes are an integral part of these consolidated financial statements.

TRIPADVISOR, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

	Year ended December 31,		
	2018	2017	2016
Net income (loss)	\$113	\$(19)	\$120
Other comprehensive income (loss):			
Foreign currency translation adjustments (1)	(20 )	35	(14 )
Total other comprehensive income (loss)	(20 )	35	(14 )
Comprehensive income	\$93	\$16	\$106

(1) Foreign currency translation adjustments exclude income taxes due to our intention to indefinitely reinvest the earnings of our foreign subsidiaries in those operations. Refer to “Note 16: Stockholders’ Equity”.

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

## TRIPADVISOR, INC.

## CONSOLIDATED BALANCE SHEETS

(in millions, except number of shares and per share amounts)

	December 31, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents (Note 7)	\$ 655	\$ 673
Short-term marketable securities (Note 7)	15	35
Accounts receivable and contract assets, net of allowance for doubtful accounts of \$21 and \$16, respectively (Note 2, Note 4)	212	230
Income taxes receivable (Note 11)	—	30
Prepaid expenses and other current assets	33	25
Total current assets	915	993
Long-term marketable securities (Note 7)	—	27
Property and equipment, net (Note 8)	253	263
Intangible assets, net (Note 9)	118	142
Goodwill (Note 9)	756	758
Deferred income taxes, net (Note 11)	27	16
Other long-term assets	98	73
<b>TOTAL ASSETS</b>	<b>\$ 2,167</b>	<b>\$ 2,272</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 15	\$ 8
Deferred merchant payables (Note 2)	164	156
Deferred revenue (Note 4)	63	60
Accrued expenses and other current liabilities (Note 12)	151	148
Total current liabilities	393	372
Long-term debt (Note 10)	—	230
Deferred income taxes, net (Note 11)	21	14
Other long-term liabilities (Note 13)	282	293
Total Liabilities	696	909
Commitments and contingencies (Note 14)		
Stockholders' equity: (Note 16)		
Preferred stock, \$0.001 par value	—	—
Authorized shares: 100,000,000		
Shares issued and outstanding: 0 and 0		
Common stock, \$0.001 par value	—	—
Authorized shares: 1,600,000,000		
Shares issued: 137,158,010 and 135,617,263, respectively		
Shares outstanding: 125,101,322 and 126,142,773, respectively		
Class B common stock, \$0.001 par value	—	—
Authorized shares: 400,000,000		
Shares issued and outstanding: 12,799,999 and 12,799,999, respectively		

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Additional paid-in capital	1,037	926
Retained earnings	1,043	926
Accumulated other comprehensive (loss) income	(62 )	(42 )
Treasury stock-common stock, at cost, 12,056,688 and 9,474,490 shares, respectively	(547 )	(447 )
Total Stockholders' Equity	1,471	1,363
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 2,167	\$ 2,272

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

TRIPADVISOR, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(in millions, except number of shares)

	Class A		Class B		Additional	Retained	Accumulated other comprehensive (loss)	Treasury stock	Total	
	Common stock Shares	Amount	Common stock Shares	Amount	paid-in capital	earnings	income	Shares	Amount	
Balance as of December 31, 2015	133,836,242	\$ —	12,799,999	\$ —	\$ 741	\$ 826	\$ (63 )	(1,393,131 )	\$ (92 )	\$ 1,412
Net income						120				120
Cumulative effect adjustment from adoption of new accounting guidance related to stock-based compensation						(1 )				(1 )
Other comprehensive loss							(14 )			(14 )
Issuance of common stock related to exercise of options and vesting of RSUs	870,225	—			7					7
Repurchase of common stock (Note 16)								(2,002,356 )	(105 )	(105 )
Withholding taxes on net share settlements of equity awards					(15 )					(15 )
Stock-based compensation (Note 6)					98					98
	134,706,467	\$ —	12,799,999	\$ —	\$ 831	\$ 945	\$ (77 )	(3,395,487 )	\$ (197 )	\$ 1,502

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



(Note 6)									
Balance as of									
December 31,									
2018	137,158,010	\$ —	12,799,999	\$ —	\$ 1,037	\$ 1,043	\$ (62 )	(12,056,688)	\$(547 ) \$ 1,471

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

## TRIPADVISOR, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Year ended December 31,		
	2018	2017	2016
Operating activities:			
Net income (loss)	\$113	\$(19 )	\$120
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of property and equipment, including amortization of internal-use software and website development	82	79	69
Amortization of intangible assets	34	32	32
Stock-based compensation expense (Note 6)	118	96	85
Deferred tax expense (benefit) and other, net	12	39	(10 )
Changes in operating assets and liabilities, net of effects from acquisitions, other investments and dispositions:			
Accounts receivable, prepaid expenses and other assets	(8 )	(36 )	(24 )
Accounts payable, accrued expenses and other liabilities	22	—	7
Deferred merchant payables	14	14	21
Income tax receivables/payables, net	13	38	20
Deferred revenue	5	(5 )	1
Net cash provided by operating activities	405	238	321
Investing activities:			
Capital expenditures, including internal-use software and website development	(61 )	(64 )	(72 )
Acquisitions and other investments, net of cash acquired (Note 3)	(24 )	—	(43 )
Purchases of marketable securities	(16 )	(63 )	(166)
Sales of marketable securities	59	105	84
Maturities of marketable securities	5	28	32
Other investing activities, net	(12 )	—	2
Net cash provided by (used in) investing activities	(49 )	6	(163)
Financing activities:			
Repurchase of common stock (Note 16)	(100)	(250)	(105)
Proceeds from 2015 credit facility, net of financing costs	5	433	101
Payments to 2015 credit facility	(235)	(296)	(210)
Proceeds from Chinese credit facilities	2	—	7
Payments to Chinese credit facilities	(10 )	—	(1 )
Proceeds from 2016 credit facility, net of financing costs	—	—	73
Payments to 2016 credit facility	—	(73 )	—
Proceeds from exercise of stock options	6	3	7
Payment of withholding taxes on net share settlements of equity awards	(26 )	(17 )	(15 )
Net cash used in financing activities	(358)	(200)	(143)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(16 )	17	(17 )

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Net increase (decrease) in cash, cash equivalents and restricted cash	(18 )	61	(2 )
Cash, cash equivalents and restricted cash at beginning of period	673	612	614
Cash, cash equivalents and restricted cash at end of period	\$655	\$673	\$612
Supplemental disclosure of cash flow information:			
Cash paid during the period for income taxes, net of refunds	\$53	\$62	\$29
Cash paid during the period for interest	\$8	\$13	\$10
Supplemental disclosure of non-cash investing and financing activities:			
Stock-based compensation capitalized with internal-use software and website			
development costs	\$13	\$13	\$12

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

TRIPADVISOR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1: ORGANIZATION AND BUSINESS DESCRIPTION

We refer to TripAdvisor, Inc. and our wholly-owned subsidiaries as “TripAdvisor,” “the Company,” “us,” “we” and “our” in these notes to the consolidated financial statements.

On December 20, 2011, Expedia Group, Inc. (“Expedia”) completed a spin-off of TripAdvisor into a separate publicly traded Delaware corporation. We refer to this transaction as the “Spin-Off.” TripAdvisor’s common stock began trading on the NASDAQ as an independent public company on December 21, 2011, under the trading symbol “TRIP.”

On December 11, 2012, Liberty Interactive Corporation, or Liberty, purchased an aggregate of approximately 4.8 million shares of common stock of TripAdvisor from Barry Diller, our former Chairman of the Board of Directors and Senior Executive, and certain of his affiliates. As a result, Liberty beneficially owned approximately 18.2 million shares of our common stock and 12.8 million shares of our Class B common stock.

On August 27, 2014, the entire beneficial ownership of our common stock and Class B common stock held by Liberty was acquired by Liberty TripAdvisor Holdings, Inc., or LTRIP. Simultaneously, Liberty, LTRIP’s former parent company, distributed, by means of a dividend, to the holders of its Liberty Ventures common stock, Liberty’s entire equity interest in LTRIP. We refer to this transaction as the “Liberty Spin-Off”. As a result of the Liberty Spin-Off, effective August 27, 2014, LTRIP became a separate, publicly traded company holding 100% of Liberty’s interest in TripAdvisor.

As a result of these transactions, as of December 31, 2018, LTRIP beneficially owned approximately 18.2 million shares of our common stock and 12.8 million shares of our Class B common stock, which constitute 14.5% of the outstanding shares of common stock and 100% of the outstanding shares of Class B common stock. Assuming the conversion of all of LTRIP’s shares of Class B common stock into common stock, LTRIP would beneficially own 22.5% of the outstanding common stock. Because each share of Class B common stock is entitled to ten votes per share and each share of common stock is entitled to one vote per share, LTRIP may be deemed to beneficially own equity securities representing 57.7% of our voting power.

#### Description of Business

TripAdvisor is an online travel company and our mission is to help people around the world to plan, book and experience the perfect trip. We seek to achieve our mission by providing consumers and travel partners a global platform with rich consumer-generated content, price comparison tools and online reservation and related services for destinations, accommodations, travel activities and experiences, and restaurants.

TripAdvisor, Inc., by and through its subsidiaries, owns and operates a portfolio of leading online travel brands. Our flagship brand is TripAdvisor. TripAdvisor-branded websites include tripadvisor.com in the United States and localized versions of the website in 48 markets and 28 languages worldwide. TripAdvisor features approximately 730 million reviews and opinions on approximately 8.1 million places to stay, places to eat and things to do – including 1.3 million hotels, inns, B&Bs and specialty lodging, 875,000 rental properties, 4.9 million restaurants and 1.0 million travel activities and experiences worldwide. We also enable consumers to compare prices and/or book a number of these travel experiences on either a TripAdvisor website or mobile app, or on the website or mobile app of one of our

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travel partners. In addition to the flagship TripAdvisor brand, we manage and operate the following other travel media brands, connected by the common goal of providing consumers the most comprehensive travel-planning and trip-taking resources in the travel industry: [www.airfarewatchdog.com](http://www.airfarewatchdog.com), [www.bokun.io](http://www.bokun.io), [www.bookingbuddy.com](http://www.bookingbuddy.com), [www.cruisecritic.com](http://www.cruisecritic.com), [www.familyvacationcritic.com](http://www.familyvacationcritic.com), [www.flipkey.com](http://www.flipkey.com), [www.thefork.com](http://www.thefork.com) (including [www.lafourchette.com](http://www.lafourchette.com), [www.eltenedor.com](http://www.eltenedor.com), and [www.iens.nl](http://www.iens.nl)), [www.holidaylettings.co.uk](http://www.holidaylettings.co.uk), [www.holidaywatchdog.com](http://www.holidaywatchdog.com), [www.housetrip.com](http://www.housetrip.com), [www.jetsetter.com](http://www.jetsetter.com), [www.niumba.com](http://www.niumba.com), [www.onetime.com](http://www.onetime.com), [www.oyster.com](http://www.oyster.com), [www.seatguru.com](http://www.seatguru.com), [www.smartertravel.com](http://www.smartertravel.com), [www.tingo.com](http://www.tingo.com), [www.vacationhomerentals.com](http://www.vacationhomerentals.com), and [www.viator.com](http://www.viator.com).

## Seasonality

Traveler expenditures in the global travel market tend to follow a seasonal pattern. As such, advertising investments made by travel partners to market to potential travelers and, therefore, our revenue and profits tend to be seasonal as well. Our financial performance tends to be seasonally highest in the second and third quarters of a year, as it is a key period for leisure travel research and trip-taking, which includes the seasonal peak in traveler hotel and rental stays, and travel activities and experiences taken, compared to the first and fourth quarters which represent seasonal low points. Further significant shifts in our business mix or adverse economic conditions could result in future seasonal patterns that are different from historical trends.

## NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation and Consolidation

The accompanying consolidated financial statements include TripAdvisor, our wholly-owned subsidiaries, and entities we control, or in which we have a variable interest and are the primary beneficiary of expected cash profits or losses. All inter-company accounts and transactions have been eliminated in consolidation. Additionally, certain prior period amounts have been reclassified for comparability with the current period presentation. The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). We believe that the assumptions underlying our consolidated financial statements are reasonable. However, these consolidated financial statements do not present our future financial position, the results of our future operations and cash flows.

One of our subsidiaries that operates in China has variable interests in affiliated entities in China in order to comply with Chinese laws and regulations, which restrict foreign investment in Internet content provision businesses. Although we do not own the capital stock of these Chinese affiliates, we consolidate their results as we are the primary beneficiary of the cash losses or profits of these variable interest affiliates and have the power to direct the activity of these affiliates. Our variable interest entities' financials were not material for all periods presented.

### Accounting Estimates

We use estimates and assumptions in the preparation of our consolidated financial statements in accordance with GAAP. Our estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of our consolidated financial statements. These estimates and assumptions also affect the reported amount of net income or loss during any period. Our actual financial results could differ significantly from these estimates. The significant estimates underlying our consolidated financial statements include: (i) recognition and recoverability of goodwill, definite-lived intangibles and other long-lived assets; and (ii) accounting for income taxes. Refer to "Note 11: Income Taxes" for further discussion of our significant income tax amounts included in our consolidated financial statements.

### Revenue Recognition

Refer to "Note 4: Revenue Recognition" for a discussion about our revenue recognition policies and other financial disclosures.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

## Cost of Revenue

Cost of revenue consists of expenses that are directly related or closely correlated to revenue generation, including direct costs, such as credit card and other booking transaction payment fees, data center costs, costs associated with prepaid tour tickets, ad serving fees, flight search fees, and other transaction costs. In addition, cost of revenue includes personnel and overhead expenses, including salaries, benefits, stock-based compensation and bonuses for certain customer support personnel who are directly involved in revenue generation.

## Selling and Marketing

Selling and marketing expenses primarily consist of direct costs, including traffic generation costs from SEM and other online traffic acquisition costs, syndication costs and affiliate program commissions, social media costs,

brand advertising, television and other offline advertising, promotions and public relations. In addition, our sales and marketing expenses consist of indirect costs such as personnel and overhead expenses, including salaries, commissions, benefits, stock-based compensation expense, and bonuses for sales, sales support, customer support and marketing employees.

We incur advertising expense, which includes traffic generation costs from SEM and other online traffic costs, affiliate program commissions, display advertising, social media, and other online, and offline (primarily television) advertising expense, promotions and public relations to promote our brands. We expense the costs associated with communicating the advertisements in the period in which the advertisement takes place. We expense the production costs associated with advertisements in the period in which the advertisement first takes place. For the years ended December 31, 2018, 2017 and 2016, we recorded advertising expense of \$544 million, \$629 million, and \$543 million, respectively, in selling and marketing expense on our consolidated statements of operations. As of December 31, 2018 and 2017, we had \$2 million and \$5 million, respectively, of prepaid advertising expenses included in prepaid expenses and other current assets on our consolidated balance sheets. We expect to fully expense our prepaid advertising asset of \$2 million as of December 31, 2018 to the consolidated statement of operations during 2019.

#### Technology and Content

Technology and content expenses consist primarily of personnel and overhead expenses, including salaries and benefits, stock-based compensation expense, and bonuses for salaried employees and contractors engaged in the design, development, testing, content support, and maintenance of our websites and mobile apps. Other costs include licensing, maintenance expense, computer supplies, telecom costs, content translation costs, and consulting costs.

#### General and Administrative

General and administrative expenses consist primarily of personnel and related overhead costs, including personnel engaged in leadership, finance, legal, and human resources, as well as stock-based compensation expense for those same personnel. General and administrative costs also include professional service fees and other fees including audit, legal, tax and accounting, and other costs including bad debt expense, non-income taxes, such as sales, use and other non-income related taxes.

#### Stock-Based Compensation

**Stock Options.** The exercise price for all stock options granted by us has been equal to the market price of the underlying shares of common stock at the date of grant. In this regard, when making stock option awards, our practice is to determine the applicable grant date and to specify that the exercise price shall be the closing price of our common stock on the date of grant. Our stock options generally have a term of ten years from the date of grant and typically vest equally over a four-year requisite service period. We amortize the grant-date fair value of our stock option grants as stock-based compensation expense over the vesting term on a straight-line basis, with the amount of compensation expense recognized at any date at least equaling the portion of the grant-date fair value of the award that is vested at that date.

The estimated grant-date fair value of stock options is calculated using a Black-Scholes Merton option-pricing model (“Black-Scholes model”). The Black-Scholes model incorporates assumptions to fair value stock-based awards, which includes the risk-free rate of return, expected volatility, expected term and expected dividend yield. Our risk-free interest rate is based on the rates currently available on zero-coupon U.S. Treasury issues, in effect at the time of the grant, whose remaining maturity period most closely approximates the stock option’s expected term assumption. Our expected volatility is calculated by equally weighting the historical volatility and implied volatility on our own

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common stock. Historical volatility is determined using actual daily price observations of our common stock price over a period equivalent to or approximate to the expected term of our stock option grants to date. Implied volatility represents the volatility calculated from the observed prices of our actively traded options on our common stock, with remaining maturities in excess of six months and market prices approximate to the exercise prices of the stock option grant. We estimate our expected term using historical exercise behavior and expected post-vest termination data. Our expected dividend yield is zero, as we have not paid any dividends on our common stock to date and do not expect to pay any cash dividends for the foreseeable future.

**Restricted Stock Units.** RSUs are stock awards that are granted to employees entitling the holder to shares of our common stock as the award vests. RSUs are measured at fair value based on the quoted price of our common stock at the date of grant. We amortize the fair value of RSUs as stock-based compensation expense over the vesting term, which is typically four years on a straight-line basis, with the amount of compensation expense recognized at any date at least equaling the portion of the grant-date fair value of the award that is vested at that date.

**Performance-Based Awards.** Performance-based stock options and RSUs vest upon achievement of certain company-based performance conditions and a requisite service period. On the date of grant, the fair value of a performance-based award is calculated using the same method as our service based stock options and RSUs described above. We then assess whether it is probable that the individual performance targets would be achieved. If assessed as probable, compensation expense will be recorded for these awards over the estimated performance period. At each reporting period, we will reassess the probability of achieving the performance targets and the performance period required to meet those targets. The estimation of whether the performance targets will be achieved and of the performance period required to achieve the targets requires judgment, and to the extent actual results or updated estimates differ from our current estimates, the cumulative effect on current and prior periods of those changes will be recorded in the period estimates are revised, or the change in estimate will be applied prospectively depending on whether the change affects the estimate of total compensation cost to be recognized or merely affects the period over which compensation cost is to be recognized. The ultimate number of shares issued and the related compensation expense recognized will be based on a comparison of the final performance metrics to the specified targets.

**Market-based performance RSUs, or market-based RSUs (“MSUs”),** vest upon achievement of specified levels of market conditions. The fair value of our MSUs is estimated at the date of grant using a Monte-Carlo simulation model. The probabilities of the actual number of market-based performance units expected to vest and resultant actual number of shares of common stock expected to be awarded are reflected in the grant date fair values; therefore, the compensation expense for these awards will be recognized assuming the requisite service period is rendered and are not adjusted based on the actual number of awards that ultimately vest.

Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive these awards, and subsequent events are not indicative of the reasonableness of our original estimates of fair value. The Company accounts for forfeitures in the period in which they occur, rather than estimate expected forfeitures.

## Income Taxes

We record income taxes under the asset and liability method. Deferred tax assets and liabilities reflect our estimation of the future tax consequences of temporary differences between the carrying amounts of assets and liabilities for book and tax purposes. We determine deferred income taxes based on the differences in accounting methods and timing between financial statement and income tax reporting. Accordingly, we determine the deferred tax asset or liability for each temporary difference based on the enacted income tax rates expected to be in effect when we realize the underlying items of income and expense. We consider all relevant factors when assessing the likelihood of future realization of our deferred tax assets, including our recent earnings experience by jurisdiction, expectations of future taxable income, and the carryforward periods available to us for tax reporting purposes, as well as assessing available tax planning strategies. We may establish a valuation allowance to reduce deferred tax assets to the amount we believe is more likely than not to be realized. Due to inherent complexities arising from the nature of our businesses, future changes in income tax law, tax sharing agreements or variances between our actual and anticipated operating results, we make certain judgments and estimates. Therefore, actual income taxes could materially vary from these estimates. We classify deferred tax assets and liabilities as noncurrent on our consolidated balance sheet.

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We record liabilities to address uncertain tax positions we have taken in previously filed tax returns or that we expect to take in a future tax return. The determination for required liabilities is based upon an analysis of each individual tax position, taking into consideration whether it is more likely than not that our tax position, based on technical merits, will be sustained upon examination.

### Cash and Cash Equivalents

Our cash consists of cash deposits held in global financial institutions. Our cash equivalents consist of highly liquid investments, including money market funds and marketable debt securities, with maturities of 90 days or less at the date of purchase.

### Short-term and Long-term Marketable Securities

We classify our marketable debt securities as either short-term or long-term based on each instrument's underlying contractual maturity date and as to whether and when we intend to sell a particular security prior to its maturity date. Marketable debt securities with maturities greater than 90 days at the date of purchase and 12 months or less remaining at the balance sheet date will be classified as short-term and marketable debt securities with maturities greater than 12 months from the balance sheet date will generally be classified as long-term. We classify our marketable equity securities, limited by policy to money market funds and mutual funds, as either a cash equivalent, short-term or long-term based on the nature of each security and its availability for use in current operations.

As of December 31, 2018 and 2017, our marketable debt securities have been classified and accounted for as available-for-sale, and therefore are carried at fair value, with the unrealized gains and losses, net of taxes, reported in accumulated other comprehensive income (loss) as a component of stockholders' equity. Fair values are determined for each individual security in the investment portfolio. We determine the appropriate classification of our marketable securities at the time of purchase and reevaluate the designations at each balance sheet date. We invest in highly-rated securities, and our investment policy limits the amount of credit exposure to any one issuer, industry group and currency. The policy requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss and providing liquidity of investments sufficient to meet our operating and capital spending requirements and debt repayments. Realized gains and losses on the sale of marketable securities are determined by specific identification of each security's cost basis. We may sell certain of our marketable securities prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration, liquidity, and duration management. The weighted average maturity of our total invested cash shall not exceed 18 months, and no security shall have a final maturity date greater than three years, according to our investment policy.

We continually review our available for sale securities to determine whether a decline in fair value below the carrying value is other than temporary. When evaluating an investment for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, and our intent to sell, or whether it is more likely than not it will be required to sell the investment before recovery of the investment's cost basis. Once a decline in fair value is determined to be other than temporary, an impairment charge is recorded and a new cost basis in the investment is established. If we do not intend to sell the security, but it is probable that we will not collect all amounts due, then only the impairment due to the credit risk would be recognized in earnings and the remaining amount of the impairment would be recognized in accumulated other comprehensive loss within stockholders' equity.

### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recognized when the right to consideration becomes unconditional and are recorded net of an allowance for doubtful accounts. We record accounts receivable at the invoiced amount. Our customer invoices are generally due 30 days from the time of invoicing. Collateral is not required for accounts receivable. For accounts outstanding longer than the contractual payment terms, we determine an allowance by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, a specific customer's ability to pay its obligations to us, and the condition of the general economy and industry as a whole.

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The following table presents the changes in our allowance for doubtful accounts for the periods presented:

	December 31, 2018 2017 2016 (in millions)		
Allowance for doubtful accounts:			
Balance, beginning of period	\$16	\$ 9	\$ 6
Charges to earnings	11	8	4
Write-offs, net of recoveries and other adjustments	(6 )	(1 )	(1 )
Balance, end of period	\$21	\$ 16	\$ 9

#### Derivative Financial Instruments

In certain circumstances, we enter into foreign currency forward exchange contracts (“forward contracts”) to reduce, to the extent practical, our potential exposure to the effects of fluctuating foreign currency exchange rates on our cash flows denominated in foreign currencies. We account for derivative instruments that do not qualify for hedge accounting as either assets or liabilities and carry them at fair value, with any subsequent adjustments to fair value recorded in interest income and other, net on our consolidated statements of operations. Monetary assets and liabilities denominated in a currency other than the functional currency of a given subsidiary are remeasured at spot rates in effect on the balance sheet date with the effects of changes in spot rates reported in interest income and other, net on our consolidated statements of operations. Accordingly, fair value changes in the forward contracts help mitigate the changes in the value of the remeasured assets and liabilities attributable to changes in foreign currency exchange rates, except to the extent of the spot-forward differences. These differences are not expected to be significant due to the short-term nature of the contracts, which to date, have typically had maturities at inception of 90 days or less. The net cash received or paid related to our derivative instruments are classified in other investing activities in our consolidated statements of cash flows. Counterparties to forward contracts consist of major international financial institutions. We monitor our positions and the credit ratings of the counterparties involved and, by policy limits, the amount of credit exposure to any one party. We do not use derivatives for trading or speculative purposes. We had not entered into any cash flow, fair value or net investment hedges as of December 31, 2018. Refer to “Note 7: Financial Instruments and Fair Value Measurements” for further disclosure on our derivatives.

#### Property and Equipment, Including Website and Software Development Costs

We record property and equipment at cost, net of accumulated depreciation. We capitalize certain costs incurred during the application development stage related to the development of websites and internal use software when it is probable the project will be completed and the software will be used as intended. Capitalized costs include internal and external costs, if direct and incremental, and deemed by management to be significant. We expense costs related to the planning and post-implementation phases of software and website development as these costs are incurred. Maintenance and enhancement costs (including those costs in the post-implementation stages) are typically expensed as incurred, unless such costs relate to substantial upgrades and enhancements to the website or software resulting in added functionality, in which case the costs are capitalized.

We compute depreciation using the straight-line method over the estimated useful lives of the assets, which is three to five years for computer equipment, capitalized software and website development, office furniture and other equipment. We depreciate leasehold improvements using the straight-line method, over the shorter of the estimated useful life of the improvement or the remaining term of the lease.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

## Leases

We lease office space in many countries around the world under non-cancelable lease agreements. We generally lease our office facilities under operating lease agreements. Office facilities subject to an operating lease and the related lease payments are not recorded on our balance sheet. The terms of certain lease agreements provide for rental payments on a graduated basis, however, we recognize rent expense on a straight-line basis over the lease

period in accordance with GAAP. Any lease incentives are recognized as reductions of rental expense on a straight-line basis over the term of the lease. The lease term begins on the date we become legally obligated for the rent payments or when we take possession of the office space, whichever is earlier.

We establish assets and liabilities for the estimated construction costs incurred under lease arrangements where we are considered the owner for accounting purposes only, or build-to-suit leases, to the extent we are involved in the construction of structural improvements or take construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, we assess whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance under GAAP. If we continue to be the deemed owner, for accounting purposes, the facilities are accounted for as financing obligations.

We also establish assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition for asset retirement obligations. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs and are included in other long-term liabilities on our consolidated balance sheet. Our asset retirement obligations were not material as of December 31, 2018 and December 31, 2017, respectively.

Refer to “Note 2: Significant Accounting Policies,” under the section New Accounting Pronouncements Not Yet Adopted, for information on the potential impact of new lease accounting guidance on our property leases which the Company will adopt on January 1, 2019.

#### Business Combinations

We account for acquired businesses using the acquisition method of accounting which requires that the tangible assets and identifiable intangible assets acquired and assumed liabilities be recorded at the date of acquisition at their respective fair values. Any excess purchase price over the estimated fair value of the net tangible and intangible assets acquired is allocated to goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes estimates and assumptions, especially with respect to intangible assets. Significant estimates in valuing certain intangible assets may include but are not limited to future expected cash flows from customer and supplier relationships, acquired technology and trade names from a market participant perspective, useful lives and discount rates. Management’s estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Valuations are performed by management or third party valuation specialists under management's supervision, where appropriate. Any changes to provisional amounts identified during the measurement period, calculated as if the accounting had been completed as of the acquisition date, are recognized in the consolidated statement of operations in the reporting period in which the adjustment amounts are determined.

#### Goodwill and Intangible Assets

##### Goodwill

We assess goodwill, which is not amortized, for impairment annually during the fourth quarter, or more frequently, if events and circumstances indicate impairment may have occurred. We test goodwill for impairment at the reporting unit level. Goodwill is assigned to reporting units that are expected to benefit from the synergies of the business combination as of the acquisition date. We evaluate our reporting units when changes in our operating structure occur, and if necessary, reassign goodwill using a relative fair value allocation approach. Once goodwill has been allocated to the reporting units, it no longer retains its identification with a particular acquisition and becomes identified with the reporting unit in its entirety. Accordingly, the fair value of the reporting unit as a whole is available to support the recoverability of its goodwill.

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The Company has the option to qualitatively assess whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. In the evaluation of goodwill for impairment, we generally first perform a qualitative assessment to determine whether it is more likely than not (i.e., a likelihood of more than 50%) that the estimated fair value of the reporting unit is less than the carrying amount. Periodically, we may choose to forgo the initial qualitative assessment and proceed directly to a quantitative analysis to assist in our annual evaluation. When assessing goodwill for impairment, our decision to perform a qualitative impairment assessment for an individual reporting unit in a given year is influenced by a number of factors, including, but not limited to the size of the

reporting unit's goodwill, the significance of the excess of the reporting unit's estimated fair value over carrying value at the last quantitative assessment date, the amount of time in between quantitative fair value assessments from the date of acquisition to establish an updated baseline quantitative analysis, and other performance and market indicators. During a qualitative assessment, if we determine that it is not more likely than not that the implied fair value of the goodwill is less than its carrying amount, no further testing is necessary. If, however, we determine that it is more likely than not that the implied fair value of the goodwill is less than its carrying amount, we then perform a quantitative assessment and compare the estimated fair value of the reporting unit to the carrying value. If the carrying value of a reporting unit exceeds its estimated fair value, the goodwill impairment is measured using the difference between the carrying value and the fair value of the reporting unit; however, any loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit.

In determining the estimated fair values of reporting units in a quantitative goodwill impairment test, we generally use a blend, of the following recognized valuation methods: the income approach (discounted cash flows model) and the market valuation approach, which we believe compensates for the inherent risks of using either model on a stand-alone basis. The discounted cash flows model indicates the fair value of the reporting units based on the present value of the cash flows that we expect the reporting units to generate in the future. Our significant estimates in the discounted cash flows model include: weighted average cost of capital; long-term rate of growth and profitability of the reporting unit; income tax rates and working capital effects. The market valuation approach indicates the fair value of the business based on a comparison to comparable publicly traded firms in similar lines of business and other precedent transactions. Our significant estimates in the market approach model include identifying similar companies with comparable business factors such as size, growth, profitability, risk and return on investment and assessing comparable revenue and/or income multiples in estimating the fair value of the reporting units. Valuations are performed by management or third party valuation specialists under management's supervision, where appropriate. We believe that the estimated fair values assigned to our reporting units in impairment tests are based on reasonable assumptions that marketplace participants would use. However, such assumptions are inherently uncertain and actual results could differ from those estimates. The use of different assumptions, estimates or judgments could trigger the need for an impairment charge, or materially increase or decrease the amount of any such impairment charge.

During the Company's annual goodwill impairment test during the fourth quarter of 2018, a qualitative assessment for each of our reporting units' goodwill was performed and we concluded it was not more likely than not that an impairment existed. Accordingly, we did not proceed to a quantitative assessment or recognize any impairment charges during the year ending December 31, 2018. As part of our qualitative assessment for our 2018 goodwill impairment analysis of our reporting units, the factors that we considered included, but were not limited to: (a) changes in macroeconomic conditions in the overall economy and the specific markets in which we operate, (b) our ability to access capital, (c) changes in the online travel industry, (d) changes in the level of competition, (e) evaluation of current and future forecasted financial results of the reporting units, (f) comparison of our current financial performance to historical and budgeted results of the reporting units, (g) change in excess of the Company's market capitalization over its book value, (h) changes in estimates, valuation inputs, and/or assumptions since the last quantitative analysis of the reporting units, (i) changes in the regulatory environment; (j) changes in strategic outlook or organizational structure and leadership of the reporting units; and (k) other relevant factors, and how these factors might impact specific performance in future periods. However, as we periodically reassess estimated future cash flows and asset fair values, changes in our estimates and assumptions may cause us to realize material impairment charges in the future.

#### Intangible Assets

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Intangible assets with estimable useful lives, or definite-lived intangibles, are carried at cost and are amortized on a straight-line basis over their estimated useful lives and reviewed for impairment upon certain triggering events. We routinely review the remaining estimated useful lives of definite-lived intangible assets. If we reduce the estimated useful life assumption, the remaining unamortized balance is amortized over the revised estimated useful life.

Intangible assets that have indefinite lives are not amortized and are tested for impairment annually during the fourth quarter, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Similar to the qualitative assessment for goodwill, we may assess qualitative factors to determine if it is more likely than not that the implied fair value of the indefinite-lived intangible asset is less than its carrying amount. If we determine that it is not more likely than not that the implied fair value of the indefinite-lived intangible asset is less than its carrying amount, no further testing is necessary. If, however, we determine that it is more likely than not that the implied fair value of the indefinite-lived intangible asset is less than its carrying amount, we compare the implied fair value of the indefinite-lived asset with its carrying amount. If the carrying amount of an individual indefinite-lived intangible asset exceeds its implied fair value, the individual asset is written down by an amount equal to such excess. The assessment of qualitative factors is optional and at our discretion. We may bypass the qualitative assessment for any indefinite-lived intangible asset in any period and resume performing the qualitative assessment in any subsequent period. We base our quantitative measurement of fair value of indefinite-lived intangible assets, using the relief-from-royalty method. This method assumes that the trade name and trademarks have value to the extent that their owner is relieved of the obligation to pay royalties for the benefits received from them. This method requires us to estimate future revenues, the appropriate royalty rate and the weighted average cost of capital, however, such assumptions are inherently uncertain and actual results could differ from those estimates. The use of different assumptions, estimates or judgments could trigger the need for an impairment charge, or materially increase or decrease the amount of any such impairment charge.

The carrying value of indefinite-lived intangible assets that is subject to annual assessment for impairment is \$30 million at December 31, 2018 and consists of trademarks and tradenames. During the Company's annual indefinite-lived intangible impairment test during the fourth quarter of 2018, a qualitative assessment was performed. As part of our qualitative assessment we considered, amongst other factors, the amount of excess fair value of our trade names and trademarks to the carrying value of those same assets, changes in estimates, and valuation input assumptions, since our previous quantitative analysis. After considering these factors and the impact that changes in such factors would have on the inputs used in our previous quantitative assessment, we determined that it was more likely than not that our indefinite-lived intangible assets were not impaired as of December 31, 2018.

#### Impairment of Long-Lived Assets

We periodically review the carrying amount of our definite-lived intangible assets and other long-term assets, including property and equipment and website and internal use software, to determine whether current events or circumstances indicate that such carrying amounts may not be recoverable. Factors that would necessitate an impairment assessment include a significant adverse change in the extent or manner in which an asset is used, a significant adverse change in legal factors or the business climate that could affect the value of the asset, or a significant decline in the observable market value of an asset, among others. If such facts indicate a potential impairment, we assess the recoverability of the asset group by determining if the carrying value of the asset group exceeds the sum of the projected undiscounted cash flows expected to result from the use and eventual disposition of the assets over the remaining economic life of the primary asset of the group. If the recoverability test indicates that the carrying value of the asset group is not recoverable, we will estimate the fair value of the asset group using appropriate valuation methodologies which would typically include an estimate of discounted cash flows, using an appropriate discount rate. Any impairment would be measured by the amount that the carrying values, of such asset groups, exceed their fair value and would be included in operating income on the consolidated statement of operations. Considerable management judgment is necessary to estimate the fair value of asset groups. Accordingly, actual results could vary significantly from such estimates. We have not identified any circumstances that would warrant an impairment charge for any recorded definite-lived intangibles or other long term assets on our consolidated balance sheet at December 31, 2018.

#### Deferred Merchant Payables

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In our Rentals free-to-list model and our Experiences offerings, we receive cash from travelers at the time of booking and we record these amounts, net of commissions, on our consolidated balance sheets as deferred merchant payables. We pay the suppliers, or the vacation rental owners and tour providers, respectively, after the travelers' use. Therefore, we receive cash from the traveler prior to paying the supplier and this operating cycle represents a

working capital source or use of cash to us. Our deferred merchant payables balance was \$164 million and \$156 million at December 31, 2018 and 2017, respectively, on our consolidated balance sheets.

#### Foreign Currency Translation and Transaction Gains and Losses

Our consolidated financial statements are reported in U.S. dollars. Certain of our subsidiaries outside of the United States use the related local currency as their functional currency and not the U.S. dollar. Therefore assets and liabilities of our foreign subsidiaries are translated at the spot rate in effect at the applicable reporting date, and the consolidated statements of operations are translated at the average exchange rates in effect during the applicable period. The resulting unrealized cumulative translation adjustment is recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity on our consolidated balance sheet.

We also have subsidiaries that have transactions in foreign currencies other than their functional currency. Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses which are reflected in our consolidated statements of operations as unrealized (based on the applicable period-end exchange rate) or realized upon settlement of the transactions. Accordingly, we have recorded net foreign currency exchange losses of \$6 million, gains of \$1 million, and losses of \$6 million for the years ended December 31, 2018, 2017 and 2016, respectively, in interest income and other, net on our consolidated statement of operations. These amounts also include transaction gains and losses, both realized and unrealized from forward contracts.

#### Fair Value Measurements and Disclosures

We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. We measure assets and liabilities at fair value based on the expected exit price, which is the amount that would be received on the sale of an asset or amount paid to transfer a liability, as the case may be, in an orderly transaction between market participants in the principal or most advantageous market in which we would transact. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability at the measurement date. The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. GAAP provides the following hierarchical levels of inputs used to measure fair value:

Level 1—Valuations are based on quoted market prices for identical assets and liabilities in active markets.

Level 2—Valuations are based on observable inputs other than quoted market 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 are based on unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

#### Certain Risks and Concentrations

Our business is subject to certain risks and concentrations, including concentration related to dependence on our relationships with our customers. For the years ended December 31, 2018, 2017 and 2016 our two most significant travel partners, Expedia (and its subsidiaries) and Booking (and its subsidiaries), each accounted for more than 10% of our consolidated revenue and combined accounted for 37%, 43% and 46%, respectively, of our consolidated revenue, with nearly all of this revenue concentrated in our Hotel segment. In addition, refer to "Note 18: Segment and

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Geographic Information” for disclosure on our concentrations for geographic revenue and products.

Financial instruments, which potentially subject us to concentration of credit risk, consist primarily of cash and cash equivalents, corporate debt securities, forward contracts, and accounts receivable. We maintain some cash and cash equivalents balances with financial institutions that are in excess of Federal Deposit Insurance Corporation

insurance limits. Our cash and cash equivalents are primarily composed of bank account balances with financial institutions primarily denominated in U.S. dollars, Euros, British pounds, and Australian dollars, as well as, money market funds. We invest in highly-rated corporate debt securities, and our investment policy limits the amount of credit exposure to any one issuer, industry group and currency. Our credit risk related to corporate debt securities is also mitigated by the relatively short maturity period required by our investment policy. Forward contracts are transacted with various international financial institutions with high credit standings, which to date, have typically had maturities of less than 90 days. Our overall credit risk related to accounts receivable is mitigated by the relatively short collection period.

#### Contingent Liabilities

Periodically, we review the status of all significant outstanding matters to assess any potential financial exposure. When (i) it is probable that an asset has been impaired or a liability has been incurred and (ii) the amount of the loss can be reasonably estimated, we record the estimated loss in our consolidated statements of operations. We provide disclosure in the notes to the consolidated financial statements for loss contingencies that do not meet both these conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the consolidated financial statements. Significant judgment may be required to determine the probability that a liability has been incurred and whether such liability is reasonably estimable. We base accruals made on the best information available at the time which can be highly subjective. The final outcome of these matters could vary significantly from the amounts included in the accompanying consolidated financial statements.

#### Treasury Stock

Shares of our common stock repurchased are recorded at cost as treasury stock and result in the reduction of stockholders' equity in our consolidated balance sheet. We may reissue these treasury shares. When treasury shares are reissued, we use the average cost method for determining the cost of reissued shares. If the issuance price is higher than the cost, the excess of the issuance price over the cost is credited to additional paid-in-capital. If the issuance price is lower than the cost, the difference is first charged against any credit balance in additional paid-in-capital from the previous issuances of treasury stock and any remaining balance is charged to retained earnings.

#### Earnings Per Share ("EPS")

Refer to "Note 5: Earnings Per Share" for a discussion about how we compute Basic EPS and Diluted EPS.

#### New Accounting Pronouncements Not Yet Adopted

In August 2018, the Financial Accounting Standards Board ("FASB") issued new accounting guidance which require a customer in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance to determine which implementation costs to capitalize as assets or expense as incurred. The accounting for the cost of the hosting component of the arrangement (i.e., service costs the customer pays for the cloud computing service) is not affected by this new guidance. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted, including adoption in any interim period. Entities have the option to apply the guidance retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently considering our timing of adoption and the transition application method. We are also in the process of evaluating the impact of adopting this guidance on our consolidated financial statements and related disclosures.

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In June 2016, the FASB issued new accounting guidance on the measurement of credit losses for financial assets measured at amortized cost, which includes accounts receivable, and available-for-sale debt securities. For financial assets measured at amortized cost, this new guidance requires an entity to: (1) estimate its lifetime expected credit losses upon recognition of the financial assets and establish an allowance to present the net amount expected to be collected; (2) recognize this allowance and changes in the allowance during subsequent periods through net income; and (3) consider relevant information about past events, current conditions and reasonable and supportable forecasts in assessing the lifetime expected credit losses. For available-for-sale debt securities, this new guidance made several targeted amendments to the existing other-than-temporary impairment model, including: (1)

requiring disclosure of the allowance for credit losses; (2) allowing reversals of the previously recognized credit losses until the entity has the intent to sell, is more-likely-than-not required to sell the securities or the maturity of the securities; (3) limiting impairment to the difference between the amortized cost basis and fair value; and (4) not allowing entities to consider the length of time that fair value has been less than amortized cost as a factor in evaluating whether a credit loss exists. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted, including interim periods within those fiscal years beginning after December 15, 2018. We are currently considering our timing of adoption and in the process of evaluating the impact of adopting this guidance on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued new guidance related to accounting for leases. The new standard amends the existing standards for lease accounting and includes the requirement for lessee recognition of right-of-use (ROU) assets and lease liabilities on the balance sheet for all leases with a term longer than twelve months, which will be initially measured at the present value of the future lease payments over the lease term. Under the new guidance, leases will be classified as either finance or operating leases, with classification affecting the pattern and presentation of expenses and cash flows on our consolidated financial statements. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB issued additional guidance on the accounting for leases which provides companies with an additional transition method, which allows companies to recognize a cumulative-effect adjustment to the opening balance of retained earnings as of the date of adoption. Under this transition method, previously presented years' financial positions and financial results would not be adjusted. We will adopt the new standard on January 1, 2019 and use the effective date as our date of initial application based on the modified retrospective approach without adjusting the comparative periods presented. Consequently, we will not update our consolidated financial statements or provide any disclosures required under the new standard for dates and periods prior to January 1, 2019.

The new guidance provides a number of optional practical expedients and exemptions available upon adoption and for ongoing accounting. We plan to elect the following practical expedients: 1) the "practical expedients package of three", which allows us at transition to continue to maintain prior accounting conclusions under the existing guidance for leases as of the adoption date, such as whether any expired or existing contracts contain leases, the classification of leases, and the accounting treatment for initial direct costs; thereby not being required to reassess these positions upon adoption of the new standard; 2) the "short-term lease recognition exemption", which allows us to forego recognition of ROU assets and lease liabilities on our consolidated balance sheet for leases with a lease term of twelve months or less and which also do not include an option to renew the lease term that we are reasonably certain to exercise; 3) elect by asset class as an accounting policy, to combine lease and non-lease components as a single component and subsequently account for the combined single component as the lease component; and 4) apply the portfolio approach to similar types of leases where the Company does not reasonably expect the outcome to differ materially from applying the new guidance to individual leases.

In anticipation of adoption, we have updated our accounting policies to reflect the accounting rules within the new guidance and have completed the implementation of our lease accounting software to support our accounting process, financial reporting and the new financial disclosure requirements. We expect to implement certain new internal controls surrounding our lease accounting process upon the adoption of the new guidance.

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We currently expect the primary effects of adoption of this new guidance to be as follows:

◆Office space leases. We expect our office space leases, except for our Headquarters Lease, to remain operating leases which we will recognize ROU assets and corresponding lease liabilities on our consolidated balance sheet under the new guidance. We expect to recognize ROU assets ranging from \$70 million to \$80 million and lease liabilities of approximately \$85 million to \$95 million based on the present value of the remaining rental payments for these office space leases as of January 1, 2019. The difference in the ROU asset and the lease liability is the result of balances already recognized related to deferred and prepaid rent balances. In addition, we do not expect our short-term lease costs, variable lease costs, primarily from rental payments that are adjusted periodically for inflation, and our initial direct costs, to be material to our consolidated financial statements.

Corporate headquarters lease. We are deemed the owner for accounting purposes of our corporate headquarters building under existing GAAP. Refer to “Note 14— Commitments and Contingencies” for additional information on the accounting under existing GAAP for our Headquarters Lease. Upon adoption of the new guidance, we expect to derecognize amounts in property and equipment, net and other long-term liabilities on our consolidated balance sheet as of December 31, 2018 of approximately \$62 million and \$70 million, respectively, with the difference recorded to our opening balance of retained earnings as of the adoption date. We expect our Headquarters Lease to be classified and accounted for as a finance lease under the new guidance as of January 1, 2019. Accordingly, we expect to then recognize an ROU asset ranging from \$105 million to \$120 million and a lease liability of approximately \$85 million to \$95 million based on the initial measurement of the present value of the remaining lease payments over the remaining lease term. The difference between the ROU asset and lease liability relates to a net prepaid rent balance.

We do not anticipate the income tax impact to be material to our consolidated financial statements from the adoption of this guidance. We also do not expect the adoption of this new guidance will have a material impact, either on an annual or quarterly basis, to our consolidated statement of operations and consolidated statement of cash flows on a go-forward basis. We expect to expand financial disclosure concerning leasing activity, including qualitative and quantitative disclosures.

#### Recently Adopted Accounting Pronouncements

In August 2018, the SEC adopted a final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, that amends certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. The amendments also expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements, in which registrants must now analyze changes in stockholders' equity, in the form of reconciliation, for the current and comparative year-to-date periods, with subtotals for each interim period, which the Company will begin applying this disclosure change in stockholders' equity analysis in its March 31, 2019, Form 10-Q. This final rule is effective on November 5, 2018 and we assessed the impact on our consolidated financial statements disclosures to be not significant.

In May 2017, the FASB issued new accounting guidance that clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications which will reduce diversity in practice. Under the new guidance, an entity will not apply modification accounting to a share-based payment award if the award's fair value (or calculated value or intrinsic value, if those measurement methods are used), the award's vesting conditions, and the award's classification as an equity or liability instrument are the same immediately before and after the change. The guidance also states that an entity is not required to estimate the value of the award immediately before and after the change if the change does not affect any of the inputs to the model used to value the award. We adopted this guidance prospectively in the first quarter of 2018 and the adoption did not have an impact on our consolidated financial statements and related disclosures. We believe the new guidance will likely result in fewer changes to the terms of an award being accounted for as modifications.

In January 2017, the FASB issued new accounting guidance to clarify the definition of a business and provide additional guidance to assist entities with evaluating whether transactions should be accounted for as asset acquisitions (or asset disposals) or business combinations (or disposals of a business). Under this new guidance, an entity first

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determines whether substantially all of the fair value of the assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this criterion is met, the transaction should be accounted for as an asset acquisition as opposed to a business combination. This distinction is important because the accounting for an asset acquisition significantly differs from the accounting for a business combination. This new guidance eliminates the requirement to evaluate whether a market participant could replace missing elements (e.g. inputs or processes), narrows the definition of outputs and requires that a business include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. We adopted this guidance in the first quarter of 2018 and it will be applied prospectively to any transactions occurring within and after the adoption date. The adoption did not have an impact on our consolidated financial statements and related disclosures.

In November 2016, the FASB issued new accounting guidance on the classification and presentation of

restricted cash in the statement of cash flows to address the diversity in practice. This new guidance requires entities to show changes in cash, cash equivalents and restricted cash on a combined basis in the statement of cash flows. In addition, this accounting guidance requires a reconciliation of the total cash, cash equivalent and restricted cash in the statement of cash flows to the related captions in the balance sheet if cash, cash equivalents and restricted cash are presented in more than one line item in the balance sheet. We adopted this guidance in the first quarter of 2018 and applied it retrospectively to all prior periods presented in the financial statements as required under the new guidance. The adoption did not have a material impact on our consolidated financial statements and related disclosures.

In October 2016, the FASB issued new accounting guidance on income tax accounting associated with intra-entity transfers of assets other than inventory. This accounting update, which is part of the FASB's simplification initiative, is intended to reduce diversity in practice and the complexity of tax accounting, particularly for those transfers involving intellectual property. This new guidance requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. We adopted this new guidance in the first quarter of 2018 on a modified retrospective basis. Accordingly, we recognized the cumulative effect of initial application of this new guidance as an adjustment to the opening balance of retained earnings, which was not material to our consolidated financial statements.

In August 2016, the FASB issued new accounting guidance which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The new guidance specifically addresses the following cash flow topics in an effort to reduce diversity in practice: (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon bonds; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions; and (8) separately identifiable cash flows and application of the predominance principle. We adopted this new guidance in the first quarter of 2018 retrospectively and the adoption did not have an impact on our consolidated financial statements and related disclosures.

In January 2016, the FASB issued new accounting guidance which amends the standard on the recognition and measurement of financial instruments. The FASB clarified certain aspects of this guidance by issuing an update for technical corrections and improvements related to this guidance in February 2018. The guidance (1) requires an entity to measure equity investments (except those accounted for under the equity method or those that result in consolidation of the investee) at fair value with changes in fair value recognized in net income rather than accumulated other comprehensive income on the balance sheet; (2) allows an entity to elect to measure the equity investments that do not have a readily determinable fair value using a new measurement alternative which measure these equity investments at cost less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (3) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; and (4) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's evaluation of their other deferred tax assets. We adopted this guidance in the first quarter of 2018 and elected to prospectively account for our investments in equity securities of privately-held companies that do not have a readily determinable fair value using the measurement alternative. The adoption did not have a material impact on our consolidated financial statements and related disclosures.

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In May 2014, the FASB issued new accounting guidance on revenue from contracts with customers, or ASC 606, Revenue from Contracts with Customers (“ASC 606”), which replaced numerous requirements in GAAP, and provides companies with a single model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This guidance also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In addition, the FASB has also issued several amendments to the standard, which clarifies certain aspects of the guidance, including principal versus agent considerations and identifying performance obligations.

In the first quarter of 2018, we adopted ASC 606 under the modified retrospective method for all contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under the new revenue guidance, while prior period amounts are not adjusted and continue to be reported in accordance with our previous accounting policies under the historical revenue guidance, or ASC 605, Revenue Recognition.

We evaluated each of our revenue streams and applied ASC 606 as further discussed in “Note 4: Revenue Recognition.” As a result of adoption of the new revenue guidance, certain revenue streams, such as our hotel instant booking revenue recorded under the consumption model which we previously recorded upon completion of the traveler stay, is now recognized upon booking. The amount of the recognized transaction price for the commission is recorded as revenue net of the impact of estimated cancellations. We also recorded an adjustment to capitalize certain costs to obtain contracts for existing arrangements as of the implementation date. We expect the adoption of this new revenue standard will not have a material impact, either on an annual or quarterly basis, to our consolidated financial statements on an ongoing basis. Our systems and internal controls were not significantly impacted as a result of the accounting changes and we have made the necessary changes to our accounting policies and internal processes to support the new revenue recognition standard, including the related disclosures.

We recognized the cumulative effect of initial application of ASC 606 as an adjustment to the opening balance of retained earnings. We recorded a net increase in opening retained earnings of \$4 million as of January 1, 2018 due to the cumulative impact of adoption of the new revenue guidance and all other accounts were not materially impacted.

### NOTE 3: ACQUISITIONS AND OTHER INVESTMENTS

During the years ended December 31, 2018 and 2016, we acquired businesses which were accounted for as purchases of businesses under the acquisition method. The fair value of purchase consideration has been allocated to tangible and identifiable intangible assets acquired and liabilities assumed, based on their respective fair values on the acquisition date, with the remaining amount recorded to goodwill. Acquired goodwill represents the premium we paid over the fair value of the net tangible and intangible assets acquired. We paid a premium in each of these transactions for a number of reasons, including expected operational synergies, the assembled workforces, and the future development initiatives of the assembled workforces. The results of each of these acquired businesses have been included in the consolidated financial statements beginning on the respective acquisition dates. Pro-forma results of operations for these acquisitions have not been presented as the financial impact to our consolidated financial statements, both individually and in aggregate, would not be materially different from historical results. For both the years ended December 31, 2018 and December 31, 2016 acquisition-related costs which were expensed as incurred, were not material and are included in general and administrative expenses on our consolidated statements of operations.

#### 2018 Acquisition of Business



During the year ended December 31, 2018, we acquired one business for a purchase price and net cash consideration of \$23 million. The cash consideration was paid from our U.S. cash.

The purchase price consideration of \$23 million was allocated to the fair value of assets acquired and liabilities assumed. The following summarizes the final allocation, in millions:

	Total
Goodwill (1)	\$ 11
Intangible assets (2)	14
Deferred tax liabilities, net	(2 )
Total purchase price consideration (3)	\$ 23

(1) Goodwill is not deductible for tax purposes.

(2) Identifiable definite-lived intangible assets acquired during 2018 were comprised of supplier relationships of

\$6 million with a weighted average life of 10 years and technology and other of \$8 million with a weighted average life of approximately 6 years. The overall weighted-average life of the identifiable definite-lived intangible assets acquired in the purchase of this business during 2018 was 8 years, and will be amortized on a straight-line basis over the estimated useful lives from acquisition date.

(3) Subject to adjustment based on indemnification obligations for general representations and warranties of certain acquired company stockholders.

#### 2016 Acquisitions of Businesses and Other Investments

During the year ended December 31, 2016, we completed five acquisitions of certain businesses with a total purchase price of \$34 million. The Company paid net cash consideration of \$29 million, which is net of \$4 million of cash acquired, and includes \$1 million in future holdback payments, which we currently expect to settle with Company common stock over the next two years. The cash consideration was paid primarily from our U.S. cash.

The aggregate purchase price consideration of \$34 million was allocated to the fair value of assets acquired and liabilities assumed. The following summarizes the final allocation, in millions:

	Total
Goodwill (1)	\$ 17
Intangible assets (2)	25
Net tangible assets (liabilities) (3)	(8 )
Total purchase price consideration (4)	\$ 34

(1) Goodwill is not deductible for tax purposes.

(2) Identifiable definite-lived intangible assets acquired during 2016 were comprised of trade names of \$4 million with a weighted average life of 10 years, customer lists and supplier relationships of \$4 million with a weighted average life of 6 years, subscriber relationships of \$5 million with a weighted average life of approximately 7 years, and technology and other of \$12 million with a weighted average life of approximately 5 years. The overall weighted-average life of the identifiable definite-lived intangible assets acquired in the purchase of these businesses during 2016 was 6 years, and will be amortized on a straight-line basis over their estimated useful lives from acquisition date.

(3) Primarily includes cash acquired of \$4 million, accounts receivable of \$2 million, and liabilities assumed, including accrued expenses and deferred merchant payables of \$3 million and \$10 million, respectively, which reflect their respective fair values at acquisition.

(4) Subject to adjustment based on indemnification obligations for general representations and warranties of certain acquired company stockholders.

During the year ended December 31, 2016, we also invested a total of \$14 million in the equity securities of privately-held companies. The cash consideration was paid primarily from our non-U.S. subsidiaries. These investments were recorded to other long-term assets on our consolidated balance sheet on the investment date.

#### NOTE 4: REVENUE RECOGNITION

##### Revenue Recognition under ASC 606

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We generate all of our revenue from contracts with customers. We recognize revenue when we satisfy a performance obligation by transferring control of the promised services to a customer in an amount that reflects the consideration that we expect to receive in exchange for those services. When we act as an agent in the transaction under ASC 606, we recognize revenue for only our commission on the arrangement. We determine revenue recognition through the following steps:

- (1) Identification of the contract, or contracts, with a customer
- (2) Identification of the performance obligations in the contract
- (3) Determination of the transaction price

- (4) Allocation of the transaction price to the performance obligations in the contract
- (5) Recognition of revenue when, or as, we satisfy a performance obligation.

At contract inception, we assess the services promised in our contracts with customers and identify a performance obligation for each promise to transfer to the customer a service (or bundle of services) that is distinct. To identify the performance obligations, we consider all of the services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices. We have provided qualitative information about our performance obligations for our principal revenue streams discussed below. There was no significant revenue recognized in the year ended December 31, 2018 related to performance obligations satisfied in prior periods. We have applied a practical expedient and do not disclose the value of unsatisfied performance obligations that have an original expected duration of less than one year, and we do not have any material unsatisfied performance obligations over one year. The value related to our remaining or partially satisfied performance obligations relates to subscription services that are satisfied over time or services that are recognized at a point in time, but not yet achieved. Our timing of services, invoicing and payments are discussed in more detail below and do not include a significant financing component. Our customer invoices are generally due 30 days from the time of invoicing.

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. Although the substantial majority of our contract costs have an amortization period of less than one year, we have determined contract costs arising from certain sales incentives have an amortization period in excess of one year given the high likelihood of contract renewal. Sales incentives are not paid upon renewal of these contracts and therefore are not commensurate with the initial sales incentive costs. Total capitalized costs to obtain a contract were approximately \$2 million as of December 31, 2018. We amortize these contract costs on a straight-line basis over the estimated customer life, which is based on historical customer retention rates. Amortization expense recorded to selling and marketing during the year ended December 31, 2018 was not material. We assess such assets for impairment when events or circumstances indicate that the carrying amount may not be recoverable.

The recognition of revenue may require the application of judgment related to the determination of the performance obligations, the timing of when the performance obligations are satisfied and other areas. The determination of our performance obligations does not require significant judgment given that we generally do not provide multiple services to a customer in a transaction, and the point in which control is transferred to the customer is readily determinable. In instances where we recognize revenue over time, we generally have either a subscription service that is recognized over time on a straight-line basis using the time-elapsed output method, or based on other output measures that provide a faithful depiction of the transfer of our services. When an estimate for cancellations is included in the transaction price, we base our estimate on historical cancellation rates. There have been no significant adjustments to our cancellation estimates and the cancellation estimates are not material. Taxes assessed by a government authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by us from a customer, are reported on a net basis, or in other words excluded from revenue on our consolidated financial statements, which is consistent with prior periods. The application of our revenue recognition policies and a description of our principal activities, organized by segment, from which we generate our revenue, are presented below.

## Hotel Segment

TripAdvisor-branded Click-based Advertising and Transaction Revenue. Our largest source of Hotel segment revenue is generated from click-based advertising on TripAdvisor-branded websites, which is primarily comprised of

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contextually-relevant booking links to our travel partners' sites. Our click-based travel partners are predominantly OTAs, and direct suppliers in the hotel category. Click-based advertising is generally priced on a CPC basis, with payments from travel partners determined by the number of travelers who click on a link multiplied by the CPC rate for each specific click. CPC rates that our travel partners pay are determined in a dynamic, competitive auction process, also known as our metasearch auction. We record click-based advertising revenue as the click occurs and traveler leads are sent to the travel partner websites as our performance obligation is fulfilled at that time. Click-based revenue is generally billed to our travel partners on a monthly basis consistent with the timing of the service. Transaction revenue is generated from our hotel instant booking feature, which enables hotel

shoppers to book directly with a travel partner, with the latter serving as the merchant of record for the transaction, without leaving our website. We earn a commission from our travel partners for each consumer that completes a hotel reservation on our website; based on a pre-determined commission rate. Our hotel instant booking revenue includes (i) arrangements where commissions are billable on all instant booking hotel reservations; and (ii) arrangements where the commission is billable only upon the completion of the traveler's stay resulting from the reservation. The travel partner provides the service to the traveler and we act as an agent under ASC 606. Our performance obligation in both arrangements is complete at the time of the booking and the commission earned is recognized upon booking, as we have no post-booking service obligations. The amount of revenue recognized for commissions which are billable contingent upon a traveler stay requires an estimate of the impact of cancellations using historical cancellation rates. Contract assets are recognized at the time of booking for commissions that are billable at the time of stay.

**TripAdvisor-branded Display-based Advertising and Subscription Revenue.** Travel partners can promote their brands in a contextually-relevant manner through a variety of display-based advertising placements on our websites. Our display-based advertising clients are predominantly direct suppliers of hotels, airlines and cruises, as well as destination marketing organizations. We also sell display-based advertising to OTAs and other travel related businesses, as well as advertisers from non-travel categories. Display-based advertising is sold predominantly on a cost per thousand impressions, or CPM, basis. The performance obligation in our display-based advertising business is to display a number of advertising impressions on our websites and we recognize revenue for impressions as they are delivered. Services are generally billed monthly. We have applied the practical expedient to measure progress toward completion, as we have the right to invoice the customer in an amount that directly corresponds with the value to the customer of our performance to date, which is measured based on impressions delivered.

In addition, we offer subscription-based advertising to hoteliers, owners of B&Bs and other specialty lodging properties. Our performance obligation is generally to enable subscribers to advertise their businesses on our website, as well as manage and promote their website URL, email address, phone number, special offers and other information related to their business. Subscription advertising services are predominantly sold for a flat fee for a contracted period of time of one year or less and revenue is recognized on a straight-line basis over the period of the subscription service as efforts are expended evenly throughout the contract period. Subscription advertising services are generally billed in advance of service. When prepayments are received, we recognize deferred revenue for the amount of prepayment in excess of revenue recognized until the performance obligation is satisfied.

**Other Hotel Revenue.** Our other Hotel revenue primarily includes revenue from non-TripAdvisor-branded websites, such as [www.bookingbuddy.com](http://www.bookingbuddy.com), [www.cruisecritic.com](http://www.cruisecritic.com), [www.onetime.com](http://www.onetime.com) and [www.smartertravel.com](http://www.smartertravel.com), which primarily includes click-based advertising and display-based advertising revenue. The performance obligations, timing of customer payments for these brands and methods of recognizing revenue are generally consistent with click-based advertising or display-based advertising revenue, as described above.

## Non-Hotel Segment

We provide information and services for consumers to research, book and experience activities and attractions in popular travel destinations both through Viator, our dedicated Experiences offering, and on our TripAdvisor website and mobile apps. We also power travel activities and experiences booking capabilities to consumers on affiliate partner websites, including some of the world's top airlines, hotel chains, and online and offline travel agencies. We work with local tour or travel activities/experiences operators ("the supplier") to provide our consumers with access to book tours, activities and experiences ("the activity") in popular destinations worldwide. We generate commissions for each booking transaction we facilitate through our online reservation system. We provide post-booking service to the consumer until the time of the activity, which is the completion of the performance obligation. Revenue is recognized at the time that the activity occurs. We do not control the activity before the supplier provides the activity to our consumers and therefore act as agent for nearly all of these transactions under ASC 606. We generally collect payment

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from the consumer at the time of booking that includes both our commission revenue and the amount due to the supplier. Our commission revenue is recorded as deferred revenue until revenue is recognized, and the amount due to the supplier is recorded to deferred merchant payables on our consolidated balance sheet, until payment is made to the supplier after the completion of the activity. To a lesser extent, we earn commissions from third-party merchant partners, who display and promote our supplier activities on

their websites to generate bookings. In these transactions, where we are not the merchant of record, we generally invoice and receive commissions directly from the third-party merchant partners. Our performance obligation is to allow the third-party merchant partners to display and promote our supplier activities on their website and we earn a commission when consumers book and complete an activity. We do not control the service and act as an agent for these transactions under ASC 606. Our performance obligation is complete and revenue is recognized at the time of the booking, as we have no post-booking obligations. We recognize this revenue net of an estimate of the impact of cancellations using historical cancellation rates. Contract assets are recognized for commissions that are billable contingent upon completion of the activity.

We also provide information and services for consumers to research and book restaurants in popular travel destinations through our dedicated restaurant reservations offering, TheFork, and on our TripAdvisor website and mobile apps. TheFork is an online restaurant booking platform operating on a number of websites (including [www.lafourchette.com](http://www.lafourchette.com), [www.eltenedor.com](http://www.eltenedor.com), and [www.iens.nl](http://www.iens.nl)), with a network of restaurant partners located primarily across Europe and Australia. Our bookable restaurants are available on [www.thefork.com](http://www.thefork.com) and on TripAdvisor-branded websites and mobile apps. We primarily generate transaction fees (or per seated diner fees) that are paid by restaurants for diners seated primarily from bookings through TheFork's online reservation system. The transaction fee is recognized as revenue after the reservation is fulfilled, or as diners are seated by our restaurant customers. Revenue is billed monthly when the transaction fees are payable, which is at the time the diner is seated. To a lesser extent, we also generate subscription fees for subscription-based advertising to restaurants, access to certain online reservation management services and marketing analytic tools provided by TheFork and TripAdvisor. As the performance obligation is to provide restaurants with access to these services over the subscription period, subscription fee revenue is recognized over the period of the subscription service on a straight-line basis as efforts are expended evenly throughout the contract period. Subscription fees are generally billable in advance of service. When prepayments are received, we recognize deferred revenue for the amount of prepayment in excess of revenue recognized until the performance obligation is satisfied.

In addition, we provide information and services for travelers to research and book vacation and short-term rental properties, including full home rentals, condominiums, villas, beach rentals, cabins and cottages. Our Rentals offering generates revenue primarily by offering individual property owners and managers the ability to list their properties on our websites and mobile apps thereby connecting homeowners with travelers through a free-to-list, commission-based option or, to a lesser extent, by an annual subscription-based fee structure. These properties are listed on [www.flipkey.com](http://www.flipkey.com), [www.holidaylettings.co.uk](http://www.holidaylettings.co.uk), [www.housetrip.com](http://www.housetrip.com), [www.niumba.com](http://www.niumba.com), and [www.vacationhomerentals.com](http://www.vacationhomerentals.com), and on our TripAdvisor-branded websites and mobile apps. We earn commissions associated with rental transactions through our free-to-list model from both the traveler and the property owner or manager. We provide post-booking service to the travelers, property owners and managers until the time the rental commences, which is the time the performance obligation is completed. Revenue from transaction fees is recognized at the time that the rental commences. We act as an agent, under ASC 606, in the transactions as we do not control any properties before the property owner provides the accommodation to the traveler and do not have inventory risk. We generally collect payment from the traveler at the time of booking that includes our commissions, which is recorded as deferred revenue until revenue is recognized, and the amount due to the property owner, which is recorded in deferred merchant payables on our consolidated balance sheet, until payment is made to the property owner after the completion of the rental. Payments for term-based subscription fees related to online advertising services for the listing of rental properties are generally due in advance. As the performance obligation is the listing service provided to the property owner or manager over the subscription period, revenue is recognized over the period of the subscription service on a straight-line basis as efforts are expended evenly throughout the contract period. We recognize deferred revenue for the amount of prepayment in excess of revenue recognized until the performance obligation is satisfied.

#### Practical Expedients and Exemptions

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We expense costs to obtain a contract as incurred, such as sales incentives, when the amortization period would have been one year or less.

We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

#### Impact of Adoption of ASC 606

The impact of the new guidance was not meaningful as of and for the year ended December 31, 2018 for the consolidated statement of operations, consolidated balance sheet, and consolidated statement of cash flows, respectively.

#### Disaggregation of Revenue

We disaggregate revenue from contracts with customers into major products/revenue sources. We have determined that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. As noted in “Note 18: Segment and Geographic Information”, our business consists of two reportable segments – Hotel and Non-Hotel. A reconciliation of disaggregated revenue to segment revenue is also included below.

	Year ended
	December 31, 2018
	(in millions)
Major products/revenue sources:	
TripAdvisor-branded click-based advertising and	
transaction revenue	\$ 722
TripAdvisor-branded display-based advertising and	
subscription revenue	308
Other hotel revenue	127
Total Hotel Revenue (1)	1,157
Non-Hotel Revenue (1)	458
Total Revenue	\$ 1,615

(1) Our revenue is recognized primarily at a point in time for both our Hotel and Non-Hotel segments.

#### Contract Balances

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

The following table provides information about the opening and closing balances of accounts receivables and contract assets from contracts with customers (in millions):

	December 31, 2018	December 31, 2017
Accounts receivable	\$ 205	\$ 230
Contract assets	7	—
Total	\$ 212	\$ 230

Accounts receivable are recognized when the right to consideration becomes unconditional. Contract assets are rights to consideration in exchange for services that we have transferred to a customer when that right is conditional on something other than the passage of time, such as commission payments that are contingent upon the completion of the service by the principal in the transaction. Contract liabilities generally include payments received in advance of performance under the contract, and are realized as revenue as the performance obligation to the customer is satisfied, which we present as deferred revenue on our consolidated balance sheets. As of January 1, 2018, we had \$59 million recorded as deferred revenue on our consolidated balance sheet, of which \$57 million was recognized in revenue and \$2 million was refunded due to cancellations by travelers during the year ended December 31, 2018. The difference between the opening and closing balances of our deferred revenue primarily results from the timing differences between when we receive customer payments and the time in which we satisfy our performance obligations. The difference between the opening and closing balances of our contract assets primarily results from the timing difference between when we satisfy our performance obligations and the time

when the principal completes the service in the transaction. There were no significant changes in contract assets or deferred revenue during the year ended December 31, 2018 related to business combinations, impairments, cumulative catch-ups or other material adjustments.

## NOTE 5: EARNINGS PER SHARE

### Basic Earnings Per Share Attributable to Common Stockholders

We compute basic earnings per share, or Basic EPS, by dividing net income by the weighted average number of common shares outstanding during the period. We compute the weighted average number of common shares outstanding during the reporting period using the total of common stock and Class B common stock outstanding as of the last day of the previous year end reporting period plus the weighted average of any additional shares issued and outstanding less the weighted average of any common shares repurchased during the reporting period.

### Diluted Earnings Per Share Attributable to Common Stockholders

Diluted earnings per share, or Diluted EPS, includes the potential dilution of common equivalent shares outstanding that could occur from stock-based awards and other stock-based commitments using the treasury stock method. We compute Diluted EPS by dividing net income (loss) by the sum of the weighted average number of common and common equivalent shares outstanding during the period. We computed the weighted average number of common and common equivalent shares outstanding during the period using the sum of (i) the number of shares of common stock and Class B common stock used in the Basic EPS calculation as indicated above, and (ii) if dilutive, the incremental weighted average common stock that we would issue upon the assumed exercise of outstanding common equivalent shares, primarily related to stock options and the vesting of restricted stock units using the treasury stock method, and (iii) if dilutive, performance-based and market-based awards based on the number of shares that would be issuable as of the end of the reporting period assuming the end of the reporting period was also the end of the contingency period.

Under the treasury stock method, the assumed proceeds calculation includes the actual proceeds to be received from the employee upon exercise of outstanding equity awards and the average unrecognized compensation cost during the period. The treasury stock method assumes that a company uses the proceeds from the exercise of an equity award to repurchase common stock at the average market price for the reporting period.

In periods of a net loss, common equivalent shares are excluded from the calculation of Diluted EPS as their inclusion would have an antidilutive effect. Accordingly, for periods in which we report a net loss, Diluted EPS is the same as Basic EPS, since dilutive common equivalent shares are not assumed to have been issued if their effect is anti-dilutive.

Below is a reconciliation of the weighted average number of shares of common stock outstanding in calculating Diluted EPS (shares in thousands and dollars in millions, except per share amounts) for the periods presented:

	Year ended December 31,		
	2018	2017	2016
<b>Numerator:</b>			
Net income (loss)	\$113	\$(19)	\$120
<b>Denominator:</b>			
Weighted average shares used to compute			
Basic EPS	138,116	140,445	145,443
Weighted average effect of dilutive securities:			
Stock options	351	-	1,129
RSUs/MSUs	1,908	-	321
Weighted average shares used to compute			
Diluted EPS	140,375	140,445	146,893
Basic EPS	\$0.82	\$(0.14)	\$0.83
Diluted EPS	\$0.81	\$(0.14)	\$0.82

Potential common shares, consisting of outstanding stock options and RSUs, totaling approximately 6.2 million, 12.5 million, and 3.9 million, respectively, for the years ending December 31, 2018, 2017 and 2016, have been excluded from the calculations of Diluted EPS because their effect would have been antidilutive. In addition, potential common shares of approximately 0.5 million, 0.6 million, and 0.1 million, respectively, for the years ending December 31, 2018, 2017 and 2016, consisting of performance-based awards, for which all targets required to trigger vesting had not been achieved, were excluded from the calculation of weighted average shares used to compute Diluted EPS for those reporting periods.

The earnings per share amounts are the same for common stock and Class B common stock because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

#### NOTE 6: STOCK BASED AWARDS AND OTHER EQUITY INSTRUMENTS

##### Stock-based Compensation Expense

The following table presents the amount of stock-based compensation expense related to stock-based awards, primarily stock options and RSUs, on our consolidated statements of operations during the periods presented:

	Year ended December 31,		
	2018	2017	2016
	(in millions)		
Cost of revenue	\$1	\$-	\$-
Selling and marketing	21	21	20

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Technology and content	51	40	40
General and administrative	45	35	25
Total stock-based compensation expense	118	96	85
Income tax benefit from stock-based compensation			
expense	(27 )	(28 )	(31 )
Total stock-based compensation expense, net of			
tax effect	\$91	\$68	\$54

We capitalized \$13 million, \$13 million and \$12 million of stock-based compensation expense as internal-use software and website development costs during the years ended December 31, 2018, 2017 and 2016, respectively.

## Stock and Incentive Plans

On December 20, 2011, our 2011 Stock and Annual Incentive Plan (the “2011 Plan”) became effective and we filed Post-Effective Amendment No. 1 on Form S-8 to Registration Statement on Form S-4 (File No. 333-178637) (the “Prior Registration Statement”) with the SEC, registering a total of 17,500,000 shares of our common stock, of which 17,400,000 shares were issuable in connection with grants of equity-based awards under our 2011 Plan (7,400,000 of which shares were originally registered on the Form S-4 and 10,000,000 of which shares were first registered on the Prior Registration Statement) and 100,000 shares were issuable under our Deferred Compensation Plan for Non-Employee Directors (refer to “Note 15: Employee Benefit Plans” below for information on our Deferred Compensation Plan for Non-Employee Directors). At our annual meeting of stockholders held on June 28, 2013, our stockholders approved an amendment to our 2011 Plan to, among other things, increase the aggregate number of shares of common stock authorized for issuance thereunder by 15,000,000 shares.

On June 21, 2018, our stockholders approved the 2018 Stock and Annual Incentive Plan (the “2018 Plan”) primarily for the purpose of providing sufficient reserves of shares of our common stock to ensure our ability to continue to provide new hires, employees and management with equity incentives. The number of shares reserved and available for issuance under the 2018 Plan is 6,000,000 plus the number of shares available for issuance (and not subject to outstanding awards) under the 2011 Plan, as of the effective date of the 2018 Plan. Both plans provide for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, and other stock-based awards to our directors, officers, employees and consultants, although no additional awards will be granted pursuant to the 2011 Plan. The summary of the material terms of both the 2018 Plan and its predecessor, the 2011 Plan, is qualified in its entirety by the full texts of the 2018 Plan and 2011 Plan previously filed.

As of December 31, 2018, the total number of shares reserved for future stock-based awards under the 2018 Plan is approximately 13.5 million shares. All shares of common stock issued in respect of the exercise of options or other equity awards have been issued from authorized, but unissued common stock.

## Stock Based Award Activity and Valuation

### 2018 Stock Option Activity

During the year ended December 31, 2018, we have issued 762,124 service-based non-qualified stock options under both the 2018 Plan and the 2011 Plan. Our stock options generally have a term of ten years from the date of grant and typically vest equally over a four-year requisite service period.

A summary of our stock option activity is presented below:

	Options Outstanding (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in millions)
Options outstanding as of December 31, 2015	5,720	\$ 53.71		
Granted	1,064	63.43		
Exercised (1)	(733 )	31.58		
Cancelled or expired	(233 )	70.76		
Options outstanding as of December 31, 2016	5,818	57.60		
Granted (2)	2,333	40.03		
Exercised (1)	(496 )	29.37		
Cancelled or expired	(802 )	65.13		
Options outstanding as of December 31, 2017	6,853	52.78		
Granted	762	43.53		
Exercised (1)	(1,162 )	37.26		
Cancelled or expired	(412 )	61.46		
Options outstanding as of December 31, 2018	6,041	\$ 54.00	6.5	\$ 47
Exercisable as of December 31, 2018	3,217	\$ 61.85	4.7	\$ 15
Vested and expected to vest after December 31, 2018 (3)	6,041	\$ 54.00	6.5	\$ 47

- (1) Inclusive of 814,635, 294,410, and 318,773 options as of December 31, 2018, 2017 and 2016, respectively, which were not converted into shares due to net share settlement in order to cover the aggregate exercise price and the required amount of employee withholding taxes. Potential shares which had been convertible under stock options that were withheld under net share settlement remain in the authorized but unissued pool under the 2018 Plan and can be reissued by the Company. Total payments for the employees' tax obligations to the taxing authorities due to net share settlements are reflected as a financing activity within the consolidated statements of cash flows.
- (2) Inclusive of 780,000 stock options awarded to our Chief Executive Officer and President, or CEO, during November 2017. The estimated grant-date fair value per option, using a Black-Scholes option pricing model was \$17.33. These stock options shall vest in equal installments on each of August 1, 2021 and August 1, 2022, subject to the CEO's continuous employment with, or performance of services for, the Company. The estimated grant-date fair value of this award will be amortized on a straight-line basis over the requisite service period through August 1, 2022.
- (3) The Company accounts for forfeitures as they occur, rather than estimate expected forfeitures as allowed under GAAP and therefore do not include a forfeiture rate in our vested and expected to vest calculation unless necessary for a performance condition award.

Aggregate intrinsic value represents the difference between the closing stock price of our common stock and the exercise price of outstanding, in-the-money options. Our closing stock price as reported on NASDAQ as of December 31, 2018 was \$53.94. The total intrinsic value of stock options exercised for the years ended December 31, 2018, 2017 and 2016 were \$20 million, \$8 million, and \$24 million, respectively.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



The fair value of stock option grants has been estimated at the date of grant using the Black–Scholes option pricing model with the following weighted average assumptions for the periods presented:

	December 31,		
	2018	2017	2016
Risk free interest rate	2.70 %	2.02 %	1.20 %
Expected term (in years)	5.45	6.13	4.85
Expected volatility	41.86 %	42.14 %	41.81 %
Expected dividend yield	— %	— %	— %

The weighted-average grant date fair value of options granted was \$18.11, \$16.50, and \$22.95 for the years ended December 31, 2018, 2017 and 2016, respectively. The total fair value of stock options vested for the years ended December 31, 2018, 2017 and 2016 were \$38 million, \$40 million, and \$28 million, respectively. Cash received from stock option exercises for the years ended December 31, 2018, 2017 and 2016 were \$6 million, \$3 million, and \$7 million, respectively.

On June 5, 2017, the Section 16 Committee of our Board of Directors approved an amendment to the nonqualified stock option award (the “Option”) granted on August 28, 2013 to Stephen Kaufer, the Company’s CEO. The amendment provided that the Option will expire on the tenth anniversary, instead of the seventh anniversary, of the grant date. Vesting conditions under the Option were not affected by this amendment. As a result of the modification, incremental fair value of \$5 million was recognized to stock-based compensation expense on a straight-line basis over the remaining vesting term, or through August 2018, in general and administrative expense on the consolidated statement of operations.

#### 2018 RSU Activity

During the year ended December 31, 2018, we granted 3,302,689 primarily service-based RSUs under the 2018 Plan and the 2011 Plan, which typically vest over a four-year requisite service period. A summary of our RSU activity is presented below:

	RSUs Outstanding (in thousands)	Weighted Average Grant- Date Fair Value Per Share	Aggregate Intrinsic Value (in millions)
Unvested RSUs outstanding as of December 31, 2015	1,750	\$ 79.02	
Granted	2,016	63.71	
Vested and released (1)	(627 )	76.02	
Cancelled	(283 )	73.06	
Unvested RSUs outstanding as of December 31, 2016	2,856	69.35	
Granted (2)(3)	4,829	41.58	
Vested and released (1)	(1,030 )	67.25	
Cancelled	(853 )	52.64	
Unvested RSUs outstanding as of December 31, 2017	5,802	48.81	
Granted	3,302	43.04	
Vested and released (1)	(1,617 )	54.22	
Cancelled	(847 )	46.43	
Unvested RSUs outstanding as of December 31, 2018	6,640	\$ 44.93	\$ 358
Expected to vest after December 31, 2018 (4)	6,640	\$ 44.93	\$ 358

(1)

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

Inclusive of 424,848, 301,932, and 173,429 RSUs as of December 31, 2018, 2017 and 2016, respectively, withheld due to net share settlement to satisfy required employee tax withholding requirements. Potential shares which had been convertible under RSUs that were withheld under net share settlement remain in the authorized but unissued pool under the 2018 Plan and can be reissued by the Company. Total payments for the employees' tax obligations to the taxing authorities due to net share settlements are reflected as a financing activity within the consolidated statements of cash flows.

- (2) Inclusive of 426,000 service-based RSUs awarded to our CEO during November 2017. The service-based RSU award provides for vesting in two equal annual installments on each of August 1, 2021 and August 1, 2022, subject to the CEO's continuous employment with, or performance of services for, the Company. The estimated grant-date fair value per RSU, based on the quoted price of our common stock on the date of grant, was \$34.71. The estimated grant-date fair value of this award will be amortized on a straight-line basis over the requisite service period through August 1, 2022.
- (3) Excludes from the 2017 RSU grants, a performance-based RSU grant for 213,000 shares awarded to our CEO during November 2017. This award provides for vesting based on the extent to which the Company achieves certain financial and/or the CEO achieves certain strategic performance metrics relative to the targets to be established by the Company's Compensation Committee. One quarter of these RSUs may vest and settle annually based on actual performance relative to the targets established annually for each of the four fiscal years ending December 31, 2018, December 31, 2019, December 31, 2020, and December 31, 2021. The estimated grant-date fair value per RSU will be calculated upon the establishment of annual performance targets and each tranche will be amortized on a straight-line basis over its requisite service period. At any point in time during the vesting period, the award's expense to date will at least equal the portion of the grant-date fair value that is expected to vest at that date. Based upon actual attainment relative to the target performance metrics, the CEO has the ability to receive up to 125% of the target number originally granted, or to be issued none at all.
- (4) The Company accounts for forfeitures as they occur, rather than estimate expected forfeitures as allowed under GAAP and therefore do not include a forfeiture rate in our vested and expected to vest calculation unless necessary for a performance condition award.

A summary of our RSU activity for MSUs is presented below:

	MSUs Outstanding (in thousands)	Weighted Average Grant- Date Fair Value Per Share	Aggregate Intrinsic Value (in millions)
Unvested MSUs outstanding as of December 31, 2016	-	\$ -	
Granted (1)	213	30.04	
Vested and released	-		
Cancelled	-		
Unvested MSUs outstanding as of December 31, 2017	213	30.04	
Granted (2)	71	59.40	
Vested and released	-	-	
Cancelled	-	-	
Unvested MSUs outstanding as of December 31, 2018	284	\$ 37.41	\$ 15

- (1) Represents 213,000 market-based RSU or MSUs awarded to the Company's CEO in November 2017. The MSU award provides for vesting based upon the Company's total shareholder return, or TSR, performance over the period commencing January 1, 2018 through December 31, 2020 relative to the TSR performance of the Nasdaq Composite Total Return Index. Based upon actual attainment relative to the target performance metric, the CEO has the ability to receive up to 125% of the target number of MSUs originally granted, or to be issued none at all.
- (2) MSUs provide for vesting based upon the Company's total shareholder return, or TSR, performance over the period commencing January 1, 2018 through December 31, 2020 relative to the TSR performance of the Nasdaq Composite Total Return Index. Based upon actual attainment relative to the target performance metric, the grantee has the ability to receive up to 200% of the target number of MSUs originally granted, or to be issued none at all. These MSUs were granted under the 2011 Plan.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

A Monte-Carlo simulation model, which simulated the present value of the potential outcomes of future stock prices and TSR of the Company and the Nasdaq Composite Total Return Index over the performance period, was used to calculate the grant-date fair value of our MSU awards. The estimated grant-date fair value of these awards is being amortized on a straight-line basis over the requisite service period through December 31, 2020.

## Unrecognized Stock-Based Compensation

A summary of our remaining unrecognized compensation expense and the weighted average remaining amortization period at December 31, 2018 related to our non-vested equity awards is presented below (in millions, except in years information):

	Stock Options	RSUs	MSUs
Unrecognized compensation expense	\$ 37	\$ 218	\$ 7
Weighted average period remaining (in years)	2.8	2.6	2.0

## NOTE 7: FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

## Cash, Cash Equivalents, Restricted Cash and Marketable Securities

The following tables show our cash, cash equivalents, restricted cash and short-term and long-term available-for-sale marketable debt securities, by major security type, that are measured at fair value on a recurring basis and were categorized using the fair value hierarchy, as well as their classification on our consolidated balance sheets, as of the periods presented (in millions):

	December 31, 2018				
	Amortized Cost	Fair Value	Cash, Cash Equivalents and Restricted Cash	Short-Term Marketable Securities	Long-Term Marketable Securities
	(1)	(2)			
Cash and restricted cash (1)	\$522	\$522	\$ 522	\$ —	\$ —
Level 1:					
Money market funds	128	128	128	—	—
Level 2:					
Commercial paper	20	20	5	15	—
Total	\$670	\$670	\$ 655	\$ 15	\$ —

	December 31, 2017				
	Amortized Cost	Fair Value	Cash, Cash Equivalents and Restricted Cash	Short-Term Marketable Securities	Long-Term Marketable Securities
	(1)	(2)			
Cash and restricted cash (1)	\$663	\$663	\$ 663	\$ —	\$ —
Level 1:					
Money market funds	1	1	1	—	—
Level 2:					

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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U.S. agency securities	11	11	—	6	5
U.S. treasury securities	1	1	—	1	—
Certificates of deposit	2	2	—	2	—
Commercial paper	11	11	9	2	—
Corporate debt securities	46	46	—	24	22
Subtotal	71	71	9	35	27
Total	\$735	\$735	\$ 673	\$ 35	\$ 27

(1) As of December 31, 2018 and 2017, our restricted cash, which primarily consists of escrowed security deposits, was not material and is included in other long-term assets on our consolidated balance sheets.

(2) As of December 31, 2018 and 2017, any unrealized gains or losses related to our marketable securities were not material.

Our cash and cash equivalents consist of cash on hand in global financial institutions, money market funds and marketable securities, with maturities of 90 days or less at the date of purchase. The remaining maturities of our long-term marketable securities range from one to three years and our short-term marketable securities include maturities that were greater than 90 days at the date purchased and had 12 months or less remaining at December 31, 2018 and 2017, respectively.

We classify our cash, cash equivalents, restricted cash and marketable securities within Level 1 and Level 2 as we value these financial instruments using quoted market prices (Level 1) or alternative pricing sources (Level 2). The valuation technique we used to measure the fair value of money market funds was derived from quoted prices in active markets for identical assets or liabilities. Fair values for Level 2 marketable securities are considered “Level 2” valuations because they are obtained from independent pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets. Our procedures include controls to ensure that appropriate fair values are recorded, including comparing the fair values obtained from our independent pricing services against fair values obtained from another independent source.

There were no material realized gains or losses related to sales of our marketable securities for the years ended December 31, 2018, 2017 and 2016. We consider any unrealized loss positions in our available-for-sale marketable debt securities to be temporary in nature and do not consider any of these investments other-than-temporarily impaired as of December 31, 2018 and December 31, 2017.

#### Derivative Financial Instruments

We typically use derivatives, or forward contracts, to reduce the effects of foreign currency exchange rate fluctuations on our cash flows primarily for the Euro versus the U.S. Dollar. For the periods ended December 31, 2018, 2017 and 2016, our forward contracts have not been designated as hedges and have typically had maturities of less than 90 days.

Our outstanding or unsettled forward contracts are carried at fair value on our consolidated balance sheets at December 31, 2018. Any gain or loss resulting from the change in fair value of our forward contracts for the years ended December 31, 2018, 2017 and 2016, has been recognized in our consolidated statement of operations in “Interest income and other, net.” We recorded a net loss of \$3 million and \$1 million for the years ended December 31, 2018 and 2017, respectively, and a net gain of \$2 million for the year ended December 31, 2016, related to our forward contracts.

The following table shows the notional principal amounts of our outstanding derivative instruments for the periods presented:

	December 31,	
	2018	2017
	(in millions)	
Foreign currency exchange-forward contracts (1)(2)	\$ 13	\$ —

(1) Derivative contracts address foreign currency exchange fluctuations for the Euro versus the U.S. dollar. The Company had two outstanding derivative contracts as of December 31, 2018 and no outstanding derivative contracts as of December 31, 2017. These outstanding derivatives are not designated as hedging instruments.

(2) The fair value of our outstanding derivatives as of December 31, 2018 was not material and was reported as a liability in accrued expenses and other current liabilities on our consolidated balance sheet. We measure the fair value of our outstanding or unsettled derivatives using Level 2 fair value inputs, as we use a pricing model that takes into account the contract terms as well as current foreign currency exchange rates in active markets.

#### Other Financial Instruments

Other financial instruments not measured at fair value on a recurring basis include accounts receivable and contract assets, accounts payable, deferred merchant payables, short-term debt, accrued expenses and other current liabilities

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



and long-term debt. The carrying amount of these financial instruments, with the exception of long-term debt, approximate their fair value because of the short maturity of these instruments as reported on our consolidated balance sheets as of December 31, 2018 and December 31, 2017, respectively. The carrying value of any long-term debt from our 2015 Credit Facility bears interest at a variable rate and therefore is also considered to approximate fair value.

In addition, we hold investments in equity securities of privately-held companies that do not have a readily determinable fair value. As of both December 31, 2018 and 2017, respectively, the total carrying value of our equity investments in these privately-held companies were \$12 million and are included in other long-term assets on our consolidated balance sheets. Our policy is to measure these investments at cost less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar

investment of the same issuer such observable price changes may include instances where the investee issues equity securities to new investors, thus creating a new indicator of fair value, as an example. On a quarterly basis, we perform a qualitative assessment considering impairment indicators to evaluate whether these investments are impaired and also monitor for any observable price changes. During the year ended December 31, 2018, we did not have any impairment loss on these equity investments. The Company recognized a loss of \$2 million related to one of our equity investments during the year ended December 31, 2017 in “Interest income and other, net” on our consolidated statements of operations.

The Company did not have any material assets or liabilities measured at fair value on a recurring basis using Level 3 unobservable inputs at both December 31, 2018 and December 31, 2017.

#### NOTE 8: PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following for the periods presented:

	December 31,	
	2018	2017
	(in millions)	
Capitalized software and website development	\$259	\$ 213
Building (1)	123	123
Leasehold improvements	41	39
Computer equipment and purchased software	52	46
Furniture, office equipment and other	18	19
	493	440
Less: accumulated depreciation	(240)	(177 )
Total	\$253	\$ 263

(1)The Company is deemed for accounting purposes to be the owner of its corporate headquarters building under GAAP, and depreciates the asset over its estimated useful life of 40 years on a straight-line basis. Refer to “Note 14: Commitments and Contingencies,” for additional information on our corporate headquarters lease.

As of December 31, 2018 and December 31, 2017, the carrying value of our capitalized software and website development costs, net of accumulated amortization, was \$99 million and \$97 million, respectively. For the years ended December 31, 2018, 2017 and 2016, we capitalized \$63 million, \$65 million and \$62 million, respectively, related to software and website development costs. For the years ended December 31, 2018, 2017 and 2016, we recorded amortization of capitalized software and website development costs of \$59 million, \$54 million and \$46 million, respectively, which is included in depreciation expense on our consolidated statements of operations for those years.

## NOTE 9: GOODWILL AND INTANGIBLE ASSETS, NET

The following table summarizes our goodwill activity by reportable segment for the periods presented:

	Hotel	Non-Hotel	Consolidated
	(in millions)		
Balance as of December 31, 2016	\$451	\$ 285	\$ 736
Other adjustments (1)	-	22	22
Balance as of December 31, 2017	\$451	\$ 307	\$ 758
Acquisitions (2)	-	11	11
Other adjustments (1)	-	(13 )	(13 )
Balance as of December 31, 2018	\$451	\$ 305	\$ 756

(1) Primarily related to impact of changes in foreign currency exchange rates to goodwill.

(2) The additions to goodwill relate to our business acquisitions. Refer to “Note 3: Acquisitions and Other Investments,” for further information.

Intangible assets, which were acquired in business combinations and recorded at fair value on the date of purchase, consist of the following for the periods presented:

	December 31,	
	2018	2017
	(in millions)	
Intangible assets with definite lives	\$228	\$224
Less: accumulated amortization	(140 )	(112 )
Intangible assets with definite lives, net	88	112
Intangible assets with indefinite lives	30	30
Total	\$118	\$142

Amortization expense was \$34 million, \$32 million, and \$32 million, respectively, for the years ended December 31, 2018, 2017 and 2016. Our indefinite-lived intangible assets relate to trade names and trademarks. There were no impairment charges recognized to our consolidated statement of operations during the years ended December 31, 2018, 2017 and 2016 related to our goodwill or intangible assets.

The following table presents the components of our intangible assets with definite lives for the periods presented:

	Weighted Average Remaining Life (in years)	December 31, 2018			December 31, 2017		
		Gross Carrying Amount (in millions)	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount (in millions)	Accumulated Amortization	Net Carrying Amount
Trade names and trademarks	5.8	\$57	\$ (28 )	\$ 29	\$58	\$ (20 )	\$ 38
Customer lists and supplier relationships	3.6	88	(53 )	35	87	(43 )	44
Subscriber relationships	3.7	34	(25 )	9	35	(22 )	13
Technology and other	3.3	49	(34 )	15	44	(27 )	17
Total	4.3	\$228	\$ (140 )	\$ 88	\$224	\$ (112 )	\$ 112

Refer to “Note 3: Acquisitions and Other Investments” above for a discussion of definite lived intangible assets acquired in business combinations during the years ended December 31, 2018 and 2016.

Our definite-lived intangible assets are being amortized on a straight-line basis. The straight-line method of amortization is currently our best estimate, or approximates to date, the distribution of the economic use of these intangible assets.

The estimated amortization expense for intangible assets with definite lives for each of the next five years, and the expense thereafter, assuming no subsequent impairment of the underlying assets or change in estimate of remaining lives, is expected to be as follows (in millions):

2019	\$28
2020	22
2021	15
2022	9

2023	7
2024 and thereafter	7
Total	\$88

## NOTE 10: DEBT

## 2015 Credit Facility

In June 2015, we entered into a five year credit agreement with a group of lenders which, among other things, provided for a \$1 billion unsecured revolving credit facility (the “2015 Credit Facility”) and immediately borrowed \$290 million. In May 2017, the 2015 Credit Facility was amended to, among other things, (i) increase the aggregate amount of revolving loan commitments available from \$1.0 billion to \$1.2 billion; and (ii) extend the maturity date of the 2015 Credit Facility from June 26, 2020 to May 12, 2022 (the “First Amendment”). Borrowings under the 2015 Credit Facility generally bear interest, at the Company’s option, at a rate per annum equal to either (i) the Eurocurrency Borrowing rate, or the adjusted LIBO rate for the interest period in effect for such borrowing; plus an applicable margin ranging from 1.25% to 2.00% (“Eurocurrency Spread”), based on the Company’s leverage ratio; or (ii) the Alternate Base Rate (“ABR”) Borrowing, which is the greatest of (a) the Prime Rate in effect on such day, (b) the New York Fed Bank Rate in effect on such day plus 1/2 of 1.00% per annum and (c) the Adjusted LIBO Rate (or LIBO rate multiplied by the Statutory Reserve Rate) for an interest period of one month plus 1.00%; in addition to an applicable margin ranging from 0.25% to 1.00% (“ABR Spread”), based on the Company’s leverage ratio. The Company may borrow from the 2015 Credit Facility in U.S dollars, Euros and British pound.

During the year ended December 31, 2018, we repaid all of our outstanding borrowings, or approximately \$230 million, under the 2015 Credit Facility. This repayment was primarily made from a one-time cash repatriation of \$325 million of foreign earnings to the United States during the year ended December 31, 2018. During the year ended December 31, 2017, we borrowed \$435 million and repaid \$296 million of our outstanding borrowings under the 2015 Credit Facility. These net borrowings during the year were primarily used to repurchase shares of our outstanding common stock under the Company’s repurchase program, which is described in “Note 16: Stockholders Equity”. During the year ended December 31, 2016, the Company borrowed \$101 million and repaid \$210 million of our outstanding borrowings on the 2015 Credit Facility.

As of December 31, 2018, we had no outstanding borrowings and approximately \$1.2 billion of borrowing capacity available under our 2015 Credit Facility. As of December 31, 2017 we had \$230 million of outstanding borrowings under a one-month interest rate period or a weighted average rate of 2.74% per annum. We are required to pay a quarterly commitment fee, at an applicable rate ranging from 0.15% to 0.30%, on the daily unused portion of the revolving credit facility for each fiscal quarter and additional fees in connection with the issuance of letters of credit. As of December 31, 2018, our unused revolver capacity was subject to a commitment fee of 0.15%, given the Company’s leverage ratio. The 2015 Credit Facility includes \$15 million of borrowing capacity available for letters of credit and \$40 million for Swingline borrowings on same-day notice. As of December 31, 2018, we had issued \$3 million of outstanding letters of credit under the 2015 Credit Facility. We recorded total interest expense and commitment fees on our 2015 Credit Facility of \$3 million, \$6 million and \$4 million for the years ended December 31, 2018, 2017 and 2016, respectively, to interest expense on our consolidated statements of operations. All unpaid interest and commitment fee amounts as of December 31, 2018 and December 31, 2017, respectively, were not material. We also incurred lender fees and debt financing costs in connection with entering into the 2015 Credit Facility and in connection with the First Amendment totaling \$5 million, which were capitalized as deferred financing costs and recorded to other long-term assets on the consolidated balance sheet. As of December 31, 2018, the Company has \$2 million remaining in deferred financing costs in connection with the 2015 Credit Facility. These costs are being amortized over the remaining term on a straight line basis and recorded to interest expense on our consolidated statements of operations.

There is no specific repayment date prior to the maturity date for any borrowings under this credit agreement. We may voluntarily repay any outstanding borrowing under the 2015 Credit Facility at any time without premium or penalty, other than customary breakage costs with respect to Eurocurrency loans. Additionally, the Company believes that the likelihood of the lender exercising any subjective acceleration rights, which would permit the lenders to accelerate repayment of any outstanding borrowings, is remote. As such, we classify any borrowings under this facility as long-term debt. The 2015 Credit Facility contains a number of covenants that, among other things, restrict our ability to: incur additional indebtedness, create liens, enter into sale and leaseback transactions, engage in mergers or consolidations, sell or transfer assets, pay dividends and distributions, make investments, loans or advances, prepay certain subordinated indebtedness, make certain acquisitions, engage in certain transactions with affiliates, amend material agreements governing certain subordinated indebtedness, and change our fiscal year.

The 2015 Credit Facility also requires us to maintain a maximum leverage ratio and contains certain customary affirmative covenants and events of default, including a change of control. If an event of default occurs, the lenders under the 2015 Credit Facility will be entitled to take various actions, including the acceleration of all amounts due under the 2015 Credit Facility. As of December 31, 2018 and 2017, we were in compliance with all of our debt covenants.

#### 2016 Credit Facility

We were party to an uncommitted facility agreement which provided for a \$73 million unsecured revolving credit facility (the “2016 Credit Facility”) with no specific expiration date. We initially borrowed \$73 million from this uncommitted credit facility during the year ended December 31, 2016, which was used for general working capital needs of the Company primarily for partial repayment of our 2015 Credit Facility, and repaid the full amount during the year ended December 31, 2017. As of December 31, 2017, there were no outstanding borrowings under the 2016 Credit Facility. In June 2018, the Company terminated the 2016 Credit Facility. We had no outstanding borrowings under the 2016 Credit Facility at the time of termination.

#### Chinese Credit Facilities

In addition to our 2015 Credit Facility, we maintain two credit facilities in China (jointly, the “Chinese Credit Facilities”).

We are party to a \$30 million, one-year revolving credit facility with Bank of America (the “Chinese Credit Facility—BOA”) that is currently subject to review on a periodic basis with no specific expiration period. Borrowings under our Chinese Credit Facility – BOA generally bear interest at a rate based on People’s Bank of China benchmark, including certain adjustments which may be made in accordance with market conditions at the time of borrowing. As of December 31, 2018 and 2017, there were no outstanding borrowings under our Chinese Credit Facility—BOA.

We are also party to a RMB 70,000,000 (approximately \$10 million) one-year revolving credit facility with J.P. Morgan Chase Bank (“Chinese Credit Facility—JPM”). Our Chinese Credit Facility—JPM generally bears interest at a rate based on People’s Bank of China benchmark, including certain adjustments which may be made in accordance with market conditions at the time of borrowing. During the year ended December 31, 2018 we repaid all outstanding borrowings, and as of December 31, 2018, there were no outstanding borrowings under our Chinese Credit Facility—JPM. As of December 31, 2017, we had \$7 million of outstanding borrowings from the Chinese Credit Facility – JPM at a weighted average interest rate of 5.00%.

#### NOTE 11: INCOME TAXES

The following table presents a summary of our domestic and foreign income before income taxes:

Year Ended  
December 31,

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



	2018	2017	2016
	(in millions)		
Domestic	\$104	\$81	\$64
Foreign	69	29	87
Total	\$173	\$110	\$151

The following table presents a summary of the components of our provision for income taxes:

	Year Ended December 31, 2018 2017 2016 (in millions)		
Current income tax expense:			
Federal	\$37	\$93	\$38
State	12	1	2
Foreign	17	6	11
Current income tax expense	66	100	51
Deferred income tax expense (benefit):			
Federal	(10)	25	(12)
State	(1 )	2	(3 )
Foreign	5	2	(5 )
Deferred income tax expense (benefit):	(6 )	29	(20)
Provision for income taxes	\$60	\$129	\$31

The Company reduced its current income tax payable by \$15 million, \$27 million and \$21 million for the years ended December 31, 2018, 2017 and 2016, respectively, for tax deductions attributable to the exercise or settlement of the Company's stock-based awards.

The significant components of our deferred tax assets and deferred tax liabilities as of December 31, 2018 and 2017 are as follows:

	December 31, 2018 2017 (in millions)	
Deferred tax assets:		
Stock-based compensation	\$44	\$36
Net operating loss carryforwards	38	56
Provision for accrued expenses	6	4
Deferred rent	3	3
Lease financing obligation	22	22
Foreign advertising spend	15	13
Deferred expense related to cost-sharing arrangement	31	26
Interest carryforward	14	7
Other	10	7
Total deferred tax assets	\$183	\$174
Less: valuation allowance	(57 )	(55 )
Net deferred tax assets	\$126	\$119
Deferred tax liabilities:		
Intangible assets	\$(57 )	\$(59 )
Property and equipment	(22 )	(21 )
Prepaid expenses	(2 )	(4 )
Building - corporate headquarters	(23 )	(20 )

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

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Deferred income related to cost-sharing arrangement	(16 )	(13 )
Total deferred tax liabilities	\$(120)	\$(117)
Net deferred tax asset (liability)	\$6	\$2

At December 31, 2018, we had federal, state and foreign net operating loss carryforwards (“NOLs”) of approximately \$6 million, \$39 million and \$126 million, respectively. If not utilized, the federal and state NOLs will expire at various times between 2020 and 2037 and the foreign NOLs will expire at various times between 2019 and 2028.

As of December 31, 2018, we had a valuation allowance of approximately of \$57 million related to certain NOL carryforwards for which it is more likely than not, the tax benefit will not be realized. This amount represented an overall increase of \$2 million over the amount recorded as of December 31, 2017. The increase is primarily related to additional foreign net operating losses, offset by releases of certain foreign valuation allowances. Except for such foreign deferred tax assets, we expect to realize all of our deferred tax assets based on a strong history of earnings in the U.S. and other jurisdictions, as well as future reversals of taxable temporary differences.

A reconciliation of the provision for income taxes to the amounts computed by applying the statutory federal income tax rate to income before income taxes is as follows:

	Year Ended December 31, 2018 2017 2016 (in millions)		
Income tax expense at the federal statutory rate	\$36	\$38	\$53
Foreign rate differential	(17)	(25)	(35)
State income taxes, net of effect of federal tax benefit	9	5	4
Unrecognized tax benefits and related interest	15	12	11
Change in cost-sharing treatment of stock-based compensation	(3 )	(5 )	(6 )
FDII, GILTI and other provisions	(5 )	—	—
Impacts related to the 2017 Tax Act	—	73	—
Research tax credit	(9 )	(8 )	(10)
Stock-based compensation	8	13	2
Change in valuation allowance	9	25	9
Local income tax on intercompany transaction (1)	10	—	—
Executive compensation	2	1	—
Other, net	5	—	3
Provision for income taxes	\$60	\$129	\$31

(1) During 2018, we completed an intra-entity transfer from Australia to the U.S. of certain intangible property (“IP”) rights associated with a subsidiary’s technology platform. This transfer resulted in an income tax expense for Australian tax purposes of approximately \$10 million. As a result of the IP transfer, we utilized NOLs and consequently released the valuation allowance on our Australian entity.

During 2011, the Singapore Economic Development Board accepted our application to receive a tax incentive under the International Headquarters Award. This incentive provides for a reduced tax rate on qualifying income of 5% as compared to Singapore’s statutory tax rate of 17% and is conditional upon our meeting certain employment and investment thresholds. This agreement has been extended until June 30, 2021 as we have met certain employment and investment thresholds. This benefit resulted in a decrease to our 2018 provision for income tax expense of \$2 million.

The 2017 Tax Act was signed into United States tax law on December 22, 2017. The 2017 Tax Act significantly changed the U.S. corporate income tax regime by, among other things, lowering the U.S. corporate tax rate from 35% to 21% effective January 1, 2018. The 2017 Tax Act also provided for a mandatory one-time tax on the deemed repatriation of accumulative foreign earnings of foreign subsidiaries (the “Transition Tax”), as well as prospective changes beginning in 2018, including additional limitations on executive compensation. Under GAAP, the effects of changes in income tax rates and laws are recognized in the period in which the new legislation is enacted.

On December 22, 2017, the Securities and Exchange Commission issued SAB 118, which allowed us to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. Accordingly, we recorded an estimate of \$67 million of Transition Tax, and \$6 million due to a remeasurement of our net deferred tax assets, during the year ended December 31, 2017, which reflected provisional amounts for those specific income tax effects of the 2017 Tax Act. December 22, 2018 marked the end of the measurement period for the purposes of SAB 118. During the measurement period, impacts of the law were recorded at the time a reasonable estimate for all or a portion of the effects were made, and provisional amounts were recognized and adjusted as information became available, prepared, or analyzed.

As permitted by SAB 118, we recorded provisional estimates for the impact of the Tax Act during the year ended December 31, 2017, and have subsequently finalized our accounting analysis based on the guidance, interpretations, and data available as of December 31, 2018. During the year ended December 31, 2018, we recorded a \$2 million income tax expense related to the Transition Tax, which reflects additional information that we obtained during 2018 related to uncertain tax positions, earnings and profits, foreign tax credits, and state taxes. We also recorded a \$2 million benefit related to the adjustment of deferred taxes based on the income tax rate that is expected to apply when such deferred taxes are settled or realized in future periods.

We are subject to additional requirements of the 2017 Tax Act during the year ended December 31, 2018. Those provisions include a deduction for foreign derived intangible income (“FDII”), a tax on global intangible low-taxed income (“GILTI”), a limitation of certain executive compensation, and other immaterial provisions. We have elected to account for GILTI as a period cost, and therefore included GILTI expense in the effective income tax rate calculation. Our 2018 effective income tax rate includes our estimates of these new provisions, with a net tax benefit of \$5 million recorded during the year ended December 31, 2018. Our estimates may be revised in future periods as we obtain additional data, and as the IRS issues new guidance implementing the law changes.

By virtue of consolidated income tax returns previously filed with Expedia, we are currently under an IRS audit for the 2009, 2010, and short-period 2011 tax years, and have various ongoing state income tax audits. We are separately under examination by the IRS for the short-period 2011, 2012 and 2013 tax years and under an employment tax audit with the IRS for the 2013 and 2014 tax years. These audits include questioning of the timing and the amount of income and deductions and the allocation of income among various tax jurisdictions. These examinations may lead to proposed or ordinary course adjustments to our taxes. We are no longer subject to tax examinations by tax authorities for years prior to 2009. As of December 31, 2018, no material assessments have resulted, except as noted below regarding our 2009 and 2010 IRS audit with Expedia.

In January 2017, as part of the IRS audit of Expedia, we received Notices of Proposed Adjustment from the IRS for the 2009 and 2010 tax years. These proposed adjustments are related to certain transfer pricing arrangements with our foreign subsidiaries, and would result in an increase to our worldwide income tax expense in an estimated range of \$10 million to \$14 million after consideration of competent authority relief, exclusive of interest and penalties. We disagree with the proposed adjustments and we intend to defend our position through applicable administrative and, if necessary, judicial remedies. Our policy is to review and update tax reserves as facts and circumstances change. Based on our interpretation of the regulations and available case law, we believe the position we have taken with regard to transfer pricing with our foreign subsidiaries is sustainable. In addition to the risk of additional tax for 2009 and 2010 transactions, if the IRS were to seek transfer pricing adjustments of a similar nature for transactions in subsequent years, we would be subject to significant additional tax liabilities.

In July 2015, the United States Tax Court (the “Court”) issued an opinion favorable to Altera Corporation (“Altera”) with respect to Altera’s litigation with the IRS. This opinion was submitted as a final decision under Tax Court Rule 155 during December 2015. The litigation relates to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera’s foreign subsidiary. In its opinion, the Court accepted Altera’s position of excluding stock based compensation from its inter-company cost-sharing arrangement. The IRS appealed the Court decision on February 19, 2016. At this time, the U.S. Department of the Treasury has not withdrawn the requirement from its regulations to include stock-based compensation in intercompany cost-sharing arrangements. The Company recorded a tax benefit of \$3 million, \$5 million and \$6 million in its consolidated statements of operations for the years ended December 31, 2018, 2017 and 2016, respectively. Since the Court’s 2015 opinion, the Company has taken total income tax benefits of \$15 million as of December 31, 2018. On July 24, 2018, the IRS won the appeals court case at the Ninth Circuit; however, on August 7, 2018, the Ninth Circuit withdrew its decision regarding

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

Altera and the case was reheard. While we have taken an income tax benefit based on the Court's 2015 opinion, as discussed above, we will continue to review the latest decisions on the case and its impact to our consolidated financial statements.

Cumulative undistributed earnings of foreign subsidiaries totaled approximately \$651 million as of December 31, 2018. During the year ended December 31, 2018, we made a one-time repatriation of \$325 million of foreign earnings to the United States primarily to repay our remaining outstanding debt under the 2015 Credit Facility. We intend to indefinitely reinvest the remaining foreign undistributed earnings although we will continue to

evaluate the impact of the 2017 Tax Act on our capital deployment within and outside the U.S. Should we distribute, or be treated under certain U.S. tax rules as having distributed, the earnings of foreign subsidiaries in the form of dividends or otherwise, we may be subject to U.S. income taxes or tax benefits. The amount of any unrecognized deferred income tax on this temporary difference is not material.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits (excluding interest and penalties) is as follows:

	December 31, 2018 2017 2016 (in millions)		
Balance, beginning of year	\$123	\$105	\$89
Increases to tax positions related to the current year	11	17	16
Increases to tax positions related to the prior year	2	1	1
Reductions due to lapsed statute of limitations	—	—	(1 )
Decreases to tax positions related to the prior year	—	—	—
Settlements during current year	—	—	—
Balance, end of year	\$136	\$123	\$105

As of December 31, 2018, we had \$136 million of unrecognized tax benefits, net of interest, which is classified as long-term and included in other long-term liabilities and deferred income taxes, net on our consolidated balance sheet. The amount of unrecognized tax benefits, if recognized, would reduce income tax expense by \$87 million, due to correlative adjustments in other tax jurisdictions. We recognize interest and penalties related to unrecognized tax benefits in income tax expense on our consolidated statement of operations. As of December 31, 2018 and 2017, total gross interest accrued was \$20 million and \$13 million, respectively. We do not anticipate any material changes in the next fiscal year.

#### NOTE 12: ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consisted of the following for the periods presented:

	December 31, 2018 2017 (in millions)	
Accrued employee salary, bonus, and related benefits	\$67	\$ 60
Accrued marketing costs	31	39
Current income taxes payable (1)	7	5
Current portion of debt (2)	-	7
Other	46	37
Total	\$151	\$ 148

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- (1) Refer to “Note 11: Income Taxes” for additional information.
- (2) The amount of debt outstanding at December 31, 2017 is related to our Chinese Credit Facilities. Refer to “Note 10: Debt,” for additional information.

## NOTE 13: OTHER LONG-TERM LIABILITIES

Other long-term liabilities consisted of the following for the periods presented:

	December 31, 2018 2017 (in millions)	
Unrecognized tax benefits (1)	\$ 148	\$ 127
Long-term income taxes payable (2)	31	61
Financing obligation, net of current portion (3)	83	84
Other (4)	20	21
Total	\$ 282	\$ 293

- (1) Refer to “Note 11: Income Taxes” for additional information on our unrecognized tax benefits. Amount includes accrued interest related to this liability.
- (2) Amount relates to the long-term portion of Transition Tax related to 2017 Tax Act. Refer to “Note 11: Income Taxes,” for additional information.
- (3) Refer to “Note 14: Commitments and Contingencies,” for additional information on our corporate headquarters lease and its related financing obligation.
- (4) Amounts primarily consist of long-term deferred rent balances related to our operating leases for office space.

## NOTE 14: COMMITMENTS AND CONTINGENCIES

We have material contractual obligations and commercial commitments that include office space leases, expected commitment fees on our 2015 Credit Facility, and purchase obligations, which are not accrued on the consolidated balance sheet at December 31, 2018 but we expect to require future cash outflows; as summarized in the following table:

	By Period				
	Less than				More than
	1				
	Total	year	1 to 3 years	3 to 5 years	5 years
	(in millions)				
Property leases, net of sublease income (1)	\$193	\$25	\$ 49	\$ 43	\$ 76
Expected commitment fee payments on 2015 Credit Facility (2)	6	2	3	1	—
Purchase obligations and other (3)	19	7	8	3	1
Total (4)	\$218	\$34	\$ 60	\$ 47	\$ 77

- (1) Estimated future minimum rental payments under operating leases with non-cancelable lease terms, including our corporate headquarters lease in Needham, MA.
- (2) Expected commitment fee payments are based on the daily unused portion of our 2015 Credit Facility, issued letters of credit, and the effective commitment fee rate as of December 31, 2018; however, these variables could change significantly in the future. Refer to “Note 10: Debt” for a discussion of the 2015 Credit Facility with

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additional information on our available borrowing capacity and effective commitment fee as of December 31, 2018.

- (3) Estimated purchase obligations that are fixed and determinable are primarily related to telecommunication and licensing contracts, with various expiration dates through approximately December 2024. These contracts have non-cancelable terms or are cancelable only upon payment of significant penalty.
- (4) Excluded from the table was \$3 million of undrawn standby letters of credit, primarily related to our property leases.

#### Office Lease Commitments

We have contractual obligations in the form of operating leases for office space for which we record the related expense on a monthly basis. Certain leases contain periodic rent escalation adjustments and renewal options. Rent expense related to such leases is recorded on a straight-line basis. Excluding our corporate headquarters lease, discussed below, we lease an aggregate of approximately 450,000 square feet of office space at approximately 40

other locations across North America, Europe and Asia Pacific, in cities such as New York, Boston, London, Sydney, Barcelona, Paris, and Beijing, primarily for our sales offices, subsidiary headquarters, and international management teams, pursuant to leases with various expiration dates, with the latest expiring in June 2027. For the years ended December 31, 2018, 2017 and 2016, we recorded rental expense of \$16 million in each year, respectively, net of sublease income of \$3 million during both the years ended December 31, 2018 and 2017, respectively, and \$2 million for the year ended December 31, 2016, related to these operating leases. In addition, certain of our lease agreements include rental payments which are adjusted periodically for inflation. We recognize these costs as our variable lease costs on our consolidated statement of operations, which were not material during the years ended December 31, 2018, 2017 and 2016.

#### Corporate Headquarters Lease

In June 2013, we entered into a lease for a new corporate headquarters building. Pursuant to the corporate headquarters lease, the landlord built an approximately 280,000 square foot rental building in Needham, Massachusetts (the “Premises”), and leased the Premises to the Company as our corporate headquarters for an initial term of 15 years and 7 months or through December 2030. The Company also has an option to extend the term of the Headquarters Lease for two consecutive terms of five years each.

Because we were involved in the construction project and were responsible for paying a significant portion of the costs of normal finish work and structural elements of the Premises, the Company was deemed for accounting purposes to be the owner of the Premises during the construction period under build to suit lease accounting guidance under GAAP. Therefore, the Company recorded project construction costs during the construction period incurred by the landlord as a construction-in-progress asset and a related construction financing obligation on our consolidated balance sheets. The amounts that the Company has paid or incurred for normal tenant improvements and structural improvements had also been recorded to the construction-in-progress asset.

Upon completion of construction at end of the second quarter of 2015, we evaluated the construction-in-progress asset and construction financing obligation for de-recognition under the criteria for “sale-leaseback” treatment under GAAP. We concluded that we had forms of continued economic involvement in the facility, and therefore did not meet the provisions for sale-leaseback accounting. This determination was based on the Company's continuing involvement with the property in the form of non-recourse financing to the lessor. Therefore, the Headquarters Lease is accounted for as a financing obligation. Accordingly, we began depreciating the building asset over its estimated useful life and incurring interest expense related to the financing obligation imputed using the effective interest rate method. We bifurcate our lease payments pursuant to the Premises into: (i) a portion that is allocated to the building (a reduction to the financing obligation) and; (ii) a portion that is allocated to the land on which the building was constructed. The portion of the lease obligations allocated to the land is treated as an operating lease that commenced in 2013. The lease costs allocated to the land are recognized as rent expense on a straight-line basis over the term of the lease and are recorded in general and administrative expense in the consolidated statements of operations. The financing obligation is considered a long-term finance lease obligation and is recorded to other long-term liabilities on our consolidated balance sheets. In the years ended December 31 2018, 2017 and 2016, the Company recorded \$7 million of interest expense in each year, respectively, \$3 million of depreciation expense in each year, respectively, and \$2 million of rent expense in each year in general and administrative expense, respectively, on our consolidated statements of operations related to the Premises.

Refer to “Note 2: Significant Accounting Policies,” under the New Accounting Pronouncements Not Yet Adopted, for information on the potential impact of new lease accounting guidance on our property leases which the Company will adopt on January 1, 2019.



As of December 31, 2018, future minimum commitments under our corporate headquarters lease and other non-cancelable operating leases for office space with terms of more than one year and contractual sublease income were as follows:

Year	Corporate Headquarters Lease (1) (in millions)	Operating Leases (in millions)	Sublease Income	Total Lease Commitments (Net of Sublease Income)
2019	\$9	\$ 19	\$ (3 )	\$ 25
2020	9	18	(2 )	25
2021	10	16	(2 )	24
2022	10	16	(2 )	24
2023	10	9	—	19
Thereafter	67	9	—	76
Total	\$115	\$ 87	\$ (9 )	\$ 193

(1) Amount includes an \$83 million financing obligation, which we have recorded in other long-term liabilities on our consolidated balance sheet at December 31, 2018, related to our corporate headquarters lease.

#### Letters of Credit

As of December 31, 2018, we have issued unused letters of credit totaling approximately \$3 million, primarily related to our property leases, which includes \$1 million delivered to the landlord of our corporate headquarters as security deposit, which amount is subject to increase under certain circumstances.

#### Legal Proceedings

In the ordinary course of business, we are parties to regulatory and legal matters, including threats thereof, arising out of our operations. These matters may involve claims involving patent and intellectual property rights (including alleged infringement of third-party intellectual property rights), tax matters (including value-added, excise, transient occupancy and accommodation taxes), regulatory compliance (including competition and consumer matters), defamation and other claims. Periodically, we review the status of all significant outstanding matters to assess any potential financial exposure. When (i) it is probable that an asset has been impaired or a liability has been incurred; and (ii) the amount of the loss can be reasonably estimated, we record the estimated loss in our consolidated statements of operations. We provide disclosures in the notes to the consolidated financial statements for loss contingencies that do not meet both of these conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the consolidated financial statements. We base accruals on the best information available at the time which can be highly subjective. Although occasional adverse decisions or settlements may occur, we do not believe that the final disposition of any of these matters will have a material adverse effect on our business. However, the final outcome of these matters could vary significantly from our estimates. Finally, there may be claims or actions pending or threatened against us of which we are currently not aware and the ultimate disposition of which could have a material adverse effect on us. All legal fees incurred by the Company related to any regulatory and legal matters are expensed in the period incurred.

#### Income Taxes

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

We are under audit by the IRS and various other domestic and foreign tax authorities with regards to income tax matters. We have reserved for potential adjustments to our provision for income taxes that may result from examinations by, or any negotiated agreements with, these tax authorities. Although we believe our tax estimates are reasonable, the final determination of audits could be materially different from our historical income tax provisions and accruals. The results of an audit could have a material effect on our financial position, results of operations, or cash flows in the period for which that determination is made.

We continue to accumulate cash flows, in foreign jurisdictions which we consider indefinitely reinvested, although we will continue to evaluate the impact of the 2017 Tax Act on our capital deployment within and outside the U.S. Any repatriation of funds currently held in foreign jurisdictions may result in U.S. income taxes or tax

benefits. Refer to “Note 11: Income Taxes” for further information on potential contingencies surrounding income taxes.

## NOTE 15: EMPLOYEE BENEFIT PLANS

### Retirement Savings Plan

The TripAdvisor Retirement Savings Plan (the “401(k) Plan”), qualifies under Section 401(k) of the Internal Revenue Code. The 401(k) Plan allows participating employees, most of our U.S. employees, to make contributions of a specified percentage of their eligible compensation. Participating employees may contribute up to 50% of their eligible salary on a pre-tax basis, but not more than statutory limits. Employee-participants age 50 and over may also contribute an additional amount of their salary on a pre-tax basis up to the IRS Catch-Up Provision Limit (or “catch-up contributions”). Employees may also contribute into the 401(k) Plan on an after-tax basis up (or “Roth 401(k) contributions”) to an annual maximum of 10%. The 401(k) Plan has an automatic enrollment feature at 6% pre-tax. We match 50% of the first 6% of employee contributions to the plan for a maximum employer contribution of 3% of a participant’s eligible earnings. The catch-up contributions are not eligible for employer matching contributions. The matching contributions portion of an employee’s account, vests after two years of service. Additionally, at the end of the 401(k) Plan year, we make a discretionary matching contribution to eligible participants. This additional discretionary matching employer contribution (or “true up”) is limited to match only contributions up to 3% of eligible compensation.

We also have various defined contribution plans for our international employees. Our contribution to the 401(k) Plan and our international defined contribution plans which are recorded in our consolidated statement of operations for the years ended December 31, 2018, 2017 and 2016 were \$13 million, \$9 million, and \$9 million, respectively.

### TripAdvisor, Inc. Deferred Compensation Plan for Non-Employee Directors

The Company also has a Deferred Compensation Plan for Non-Employee Directors (the “Plan”). Under the Plan, eligible directors who defer their directors’ fees may elect to have such deferred fees (i) applied to the purchase of share units, representing the number of shares of our common stock that could have been purchased on the date such fees would otherwise be payable, or (ii) credited to a cash fund. The cash fund will be credited with interest at an annual rate equal to the weighted average prime or base lending rate of a financial institution selected in accordance with the terms of the Plan and applicable law. Upon termination of service as a director of TripAdvisor, a director will receive (i) with respect to share units, such number of shares of our common stock as the share units represent, and (ii) with respect to the cash fund, a cash payment. Payments upon termination will be made in either one lump sum or up to five annual installments, as elected by the eligible director at the time of the deferral election.

Under the 2011 Plan, 100,000 shares of TripAdvisor common stock are available for issuance to non-employee directors. From the inception of the Plan through December 31, 2018, a total of 4,645 shares have been reserved for such purpose.

### TripAdvisor, Inc. Executive Severance Plan and Summary Plan Description

Effective August 7, 2017, the Company adopted an Executive Severance Plan and Summary Plan Description (the “Severance Plan”) applicable to certain employees of the Company and its subsidiaries. The Severance Plan formalizes and standardizes the Company’s severance practices for certain designated employees (each, a “Participant” and, collectively, the “Participants”). Participants covered by the Severance Plan generally will be eligible to receive severance benefits in the event of a termination by the Company without Cause or, under certain circumstances, by the

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Participant for Good Reason. The severance benefits differ if there is a termination of employment in connection with a Change in Control. The severance benefits provided pursuant to the Severance Plan are determined based on the job classification of the Participants (as reflected in internal job profile designations) and, in certain cases, their years of service with the Company.

Under the Severance Plan, in the event of a termination by the Company without Cause more than three months prior to a Change in Control or more than twelve months following a Change in Control, the severance benefits for the Participant generally shall consist of the following:

- continued payment of base salary for a period of six to eighteen months following the date of such Participant's termination of employment; and
- continuation of coverage under the Company's health insurance plan through the Company's payment of COBRA premiums for a period of six to eighteen months following the date of such Participant's termination of employment.

Under the Severance Plan, in the event of a termination by the Company without Cause or by the Participant for Good Reason, in each case within three months prior to or twelve months following a Change in Control, the severance benefits for the Participant shall consist of the following:

- payment of a lump sum amount equal to (i) twelve to twenty-four months of the Participant's Base Salary, plus (ii) the Participant's Target Bonus multiplied by 1, 1.5 or 2; and
- payment of a lump sum amount equal to the premiums required to continue the Participant's medical coverage under the Company's health insurance plan for a period of twelve to twenty-four months.

The foregoing summary is qualified in its entirety by reference to the Executive Severance Plan and Summary Plan Description incorporated herein by reference as Exhibit 10.23 to this Annual Report on Form 10-K. During the year ended December 31, 2018, severance recorded under the Severance Plan in our consolidated statement of operations was not material. During the year ended December 31, 2017, we recorded \$1 million of severance under the Severance Plan in our consolidated statement of operations.

## NOTE 16: STOCKHOLDERS' EQUITY

### Preferred Stock

In addition to common stock, we are authorized to issue up to 100 million preferred shares, with \$ 0.001 par value per share, with terms determined by our Board of Directors, without further action by our stockholders. As of December 31, 2018, no preferred shares had been issued.

### Common Stock and Class B Common Stock

Our authorized common stock consists of 1.6 billion shares of common stock with par value of \$0.001 per share, and 400 million shares of Class B common stock with par value of \$0.001 per share. Both classes of common stock qualify for and share equally in dividends, if declared by our Board of Directors. Common stock is entitled to one vote per share and Class B common stock is entitled to 10 votes per share. Holders of TripAdvisor common stock, acting as a single class, are entitled to elect a number of directors equal to 25% percent of the total number of directors,

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rounded up to the next whole number, which was two directors as of December 31, 2018. Class B common stockholders may, at any time, convert their shares into common stock, on a one for one share basis. Upon conversion, the Class B common stock is retired and is not available for reissue. In the event of liquidation, dissolution, distribution of assets or winding-up of TripAdvisor the holders of both classes of common stock have equal rights to receive all the assets of TripAdvisor after the rights of the holders of the preferred stock have been satisfied. There were 137,158,010 and 125,101,322 shares of common stock issued and outstanding, respectively, and 12,799,999 shares of Class B common stock issued and outstanding at December 31, 2018.

## Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive loss is primarily comprised of accumulated foreign currency translation adjustments, as follows for the periods presented:

	December 31, 2018 2017 (in millions)	
Cumulative foreign currency translation		
adjustments (1)	\$ (62 )	\$ (42 )
Total accumulated other comprehensive loss (2)	\$ (62 )	\$ (42 )

(1) Due to our intention to indefinitely reinvest foreign subsidiary earnings in those operations; deferred taxes are not provided on foreign currency translation adjustments.

(2) Our accumulated net unrealized gain (loss) on available for sale debt securities was not material as of December 31, 2018 and December 31, 2017.

## Treasury Stock

On February 15, 2013, our Board of Directors authorized the repurchase of \$250 million of our shares of common stock under a share repurchase program. During the year ended December 31, 2016, we repurchased 2,002,356 shares of the Company's outstanding common stock under this share repurchase program at an average cost of \$52.33 per share, exclusive of fees and commissions, or \$105 million in the aggregate, and completed this share repurchase program authorized by our Board of Directors.

On January 25, 2017, our Board of Directors authorized the repurchase of \$250 million of our shares of common stock under a share repurchase program. During the year ended December 31, 2017, we repurchased a total of 6,079,003 shares of the Company's outstanding common stock under this share repurchase program at an average share price of \$41.13, exclusive of fees and commissions, or \$250 million in the aggregate, and completed this share repurchase program. As of December 31, 2017, there were 9,474,490 shares of the Company's common stock held in treasury with an aggregate cost of \$447 million.

On January 31, 2018, our Board of Directors authorized an additional repurchase of up to \$250 million of our shares of common stock under a share repurchase program. This share repurchase program has no expiration date but may be suspended or terminated by the Board of Directors at any time. During the year ended December 31, 2018, we repurchased 2,582,198 shares of our outstanding common stock at an average share price of \$38.73 per share, exclusive of fees and commissions, or \$100 million in the aggregate. As of December 31, 2018, we had a remaining \$150 million available to repurchase shares of our common stock under this share repurchase program. As of December 31, 2018, there were 12,056,688 shares of the Company's common stock held in treasury with an aggregate cost of \$547 million.

Our Board of Directors authorized and directed management, working with the Executive Committee of our Board of Directors, to affect the share repurchase programs discussed above in compliance with applicable legal requirements.

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

## Dividends

During the years ended December 31, 2018, 2017 and 2016, our Board of Directors did not declare any dividends on our outstanding common stock and do not expect to pay any dividends for the foreseeable future. Our ability to pay dividends is also limited by the terms of our 2015 Credit Facility.

## NOTE 17: RELATED PARTY TRANSACTIONS

### Relationship between Expedia and TripAdvisor

Upon consummation of the Spin-Off, Expedia was considered a related party under GAAP based on a number of factors, including, among others, common ownership of our shares and those of Expedia. However, we no longer consider Expedia a related party. For purposes of governing certain of the ongoing relationships between us and Expedia at and after the Spin-Off, and to provide for an orderly transition, we and Expedia entered into various agreements at the time of the Spin-Off, which TripAdvisor has satisfied its obligations. However, TripAdvisor continues to be subject to certain post Spin-Off obligations under the Tax Sharing Agreement.

Under the Tax Sharing Agreement between us and Expedia, we are generally required to indemnify Expedia for any taxes resulting from the Spin-Off (and any related interest, penalties, legal and professional fees, and all costs and damages associated with related stockholder litigation or controversies) to the extent such amounts resulted from (i) any act or failure to act by us described in the covenants in the tax sharing agreement, (ii) any acquisition of our equity securities or assets or those of a member of our group, or (iii) any failure of the representations with respect to us or any member of our group to be true or any breach by us or any member of our group of any covenant, in each case, which is contained in the separation documents or in the documents relating to the IRS private letter ruling and/or the opinion of counsel. The full text of the Tax Sharing Agreement is incorporated by reference in this Annual Report on Form 10-K as Exhibit 10.2. Refer to “Note 11: Income Taxes” above for information regarding the status of completed and ongoing IRS audits of our consolidated income tax returns with Expedia to date.

### Relationship between Liberty TripAdvisor Holdings, Inc. and TripAdvisor

We consider Liberty TripAdvisor Holdings, Inc. (“LTRIP”) a related party. As of December 31, 2018, LTRIP beneficially owned approximately 18.2 million shares of our common stock and 12.8 million shares of our Class B common stock, which constitute 14.5% of the outstanding shares of common stock and 100% of the outstanding shares of Class B common stock. Assuming the conversion of all of LTRIP’s shares of Class B common stock into common stock, LTRIP would beneficially own 22.5% of the outstanding common stock. Because each share of Class B common stock is entitled to ten votes per share and each share of common stock is entitled to one vote per share, LTRIP may be deemed to beneficially own equity securities representing 57.7% of our voting power. Refer to “Note 1: Organization and Business Description” above, which describes the evolution of our relationship with LTRIP.

We had no related party transactions with LTRIP during the years ended December 31, 2018, 2017 or 2016.

## NOTE 18: SEGMENT AND GEOGRAPHIC INFORMATION

Our reporting structure includes two reportable segments: Hotel and Non-Hotel. Our Non-Hotel segment consists of the aggregation of three operating segments: Experiences, Restaurants and Rentals. The nature of the services provided are summarized in “Note 4: Revenue Recognition”.

Our operating segments are determined based on how our chief operating decision maker manages our business, regularly assesses information and evaluates performance for operating decision-making purposes, including allocation of resources. The chief operating decision maker for the Company is our CEO.

Adjusted EBITDA is our segment profit measure and a key measure used by our management and board of directors to understand and evaluate the operating performance of our business and on which internal budgets and forecasts are

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

based and approved. In particular, the exclusion of certain expenses in calculating Adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Accordingly, we believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors. We define Adjusted EBITDA as net income (loss) plus: (1) provision for income taxes; (2) other income (expense), net; (3) depreciation of property and equipment, including amortization of internal use software and website development; (4) amortization of intangible assets; (5) stock-based compensation and other stock-settled obligations; (6) goodwill, long-lived asset and intangible asset impairments; (7) legal reserves and settlements; and (8) non-recurring expenses and income. During

the fourth quarter of 2018, the Company revised its Adjusted EBITDA definition to exclude legal reserves and settlements, as the Company believes these costs are not directly tied to the core operations of our business. The Company believes that excluding these amounts better enables management and investors to compare segment financial results between periods as these costs may vary independent of business performance. This revision to our Adjusted EBITDA definition did not have a material impact to our segment financial results for any period prior to the year ended December 31, 2018, therefore no reclassifications have been made to conform the prior periods to the current period presentation.

The following tables present our segment information for the years ended December 31, 2018, 2017 and 2016, and includes a reconciliation of Adjusted EBITDA to Net Income. We record depreciation of property and equipment, including amortization of internal-use software and website development, amortization of intangible assets, stock-based compensation and other stock-settled obligations, legal reserves and settlements, other income (expense), net, other non-recurring expenses and income, net, and income taxes, which are excluded from segment operating performance, in corporate and unallocated. In addition, we do not report our assets, capital expenditures and related depreciation expense by segment as our chief operating decision maker does not use this information to evaluate operating segments. Accordingly, we do not regularly provide such information by segment to our chief operating decision maker. Intersegment revenue is not material and, in addition, already eliminated in the information by segment provided to our chief operating decision maker. Our consolidated general and administrative expenses, excluding stock-based compensation costs, are shared by all operating segments. Each operating segment receives an allocated charge based on the segment's percentage of the Company's total personnel costs.

Year ended December 31, 2018				
Corporate and				
	Hotel	Non-Hotel	unallocated	Total
	(in millions)			
Revenue	\$ 1,157	\$ 458	\$ —	\$ 1,615
Adjusted EBITDA (1)	356	66	—	422
Depreciation			(82 )	(82 )
Amortization of intangible assets			(34 )	(34 )
Stock-based compensation			(118 )	(118 )
Legal reserves and settlements			(5 )	(5 )
Operating income				183
Other expense, net				(10 )
Income before income taxes				173
Provision for income taxes				(60 )
Net income				\$ 113

Year ended December 31, 2017				
Corporate and				
	Hotel	Non-Hotel	unallocated	Total
	(in millions)			
Revenue	\$ 1,196	\$ 360	\$ —	\$ 1,556



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Adjusted EBITDA (1)	286	45	—	331
Depreciation			(79 )	(79 )
Amortization of intangible assets			(32 )	(32 )
Stock-based compensation			(96 )	(96 )
Operating income				124
Other expense, net				(14 )
Income before income taxes				110
Provision for income taxes (2)				(129 )
Net loss				\$(19 )

Year ended December 31, 2016				
Corporate and				
	Hotel	Non-Hotel	unallocated	Total
	(in millions)			
Revenue	\$ 1,190	\$ 290	\$ —	\$ 1,480
Adjusted EBITDA (1)	380	(28 )	—	352
Depreciation			(69 )	(69 )
Amortization of intangible assets			(32 )	(32 )
Stock-based compensation			(85 )	(85 )
Operating income				166
Other expense, net				(15 )
Income before income taxes				151
Provision for income taxes				(31 )
Net income				\$ 120

(1) Includes allocated general and administrative expenses in our Hotel segment of \$77 million, \$81 million and \$80 million; and in our Non-Hotel segment of \$50 million, \$42 million and \$38 million for the years ended December 31, 2018, 2017 and 2016, respectively.

(2) The year ended December 31, 2017 reflects \$67 million of Transition Tax and \$6 million of tax expense recorded due to the remeasurement of net deferred tax assets related to the 2017 Tax Act enacted on December 22, 2017.

Refer to “Note 11: Income Taxes” for further information.

#### Revenue and Geographic Information

Our revenue sources within our Hotel segment, which are TripAdvisor-branded click-based and transaction revenue, TripAdvisor-branded display-based advertising and subscription revenue; and other hotel revenue, which along with our Non-Hotel revenue source, comprise our products.

The following table presents revenue by source for the periods presented:

Year ended December 31,			
	2018	2017	2016
	(in millions)		
TripAdvisor-branded click-based and transaction	\$ 722	\$ 756	\$ 750
TripAdvisor-branded display-based advertising and			
subscription	308	292	282
Other hotel revenue	127	148	158
Non-hotel revenue	458	360	290
Total revenue	\$ 1,615	\$ 1,556	\$ 1,480



During the fourth quarter of 2018, the Company revised the basis in which it measures geographic revenue information to the physical location of the TripAdvisor subsidiary which generates the revenue, which is consistent with our measurement of long-lived physical assets, or property and equipment, net. This change had no effect on our consolidated financial statements. The geographic classification is independent of where the consumer resides, where the consumer is physically located while using the Company's services, or the location of the travel service provider, experience operator or restaurant. For example, a reservation made through TripAdvisor.com at a hotel in the U.S. by a consumer in the U.S. could be part of the Company's non-U.S. revenue. All prior periods have been reclassified to conform to the current period presentation. These reclassifications also had no effect on our consolidated financial statements.

	Year ended December 31, 2018 2017 2016 (in millions)		
<b>Revenue</b>			
United States	\$835	\$802	\$718
United Kingdom	508	530	564
All other countries	272	224	198
<b>Total revenue</b>	<b>\$1,615</b>	<b>\$1,556</b>	<b>\$1,480</b>

The Company's property and equipment, net for the United States and all other countries based on the geographic location of the assets for the periods presented:

	December 31, 2018 2017 (in millions)	
<b>Property and equipment, net</b>		
United States	\$ 214	\$ 219
All other countries	39	44
<b>Total</b>	<b>\$ 253</b>	<b>\$ 263</b>

#### NOTE 19: INTEREST INCOME AND OTHER, NET

The following table presents the detail of interest income and other, net, for the periods presented:

	Year Ended December 31, 2018 2017 2016 (in millions)		
Net gain (loss), realized and unrealized, on foreign currency exchange and foreign currency derivative contracts and other, net	\$(6)	\$ 2	\$(4)

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, depending on the terms of the warrants.

Interest income	7	1	1
Gain/(loss) on investment in privately-held companies	1	(2 )	—
Total	\$2	\$ 1	\$ (3 )

## NOTE 20: QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table presents selected unaudited financial information for the eight quarters in the period ended December 31, 2018. The results for any quarter are not necessarily indicative of future quarterly results and, accordingly, period to period comparisons should not be relied upon as an indication of future performance.

	Three Months Ended			
	March 31	June 30	September 30	December 31
(in millions, except per share data)				
<b>Year ended December 31, 2018</b>				
Revenue	\$378	\$ 433	\$ 458	\$ 346
Operating income	23	49	89	23
Net income	5	32	69	7
Basic earnings per share (1)	\$0.04	\$ 0.23	\$ 0.50	\$ 0.05
Diluted earnings per share (1)	\$0.04	\$ 0.23	\$ 0.49	\$ 0.05
<b>Year ended December 31, 2017</b>				
Revenue	\$372	\$ 424	\$ 439	\$ 321
Operating income	27	46	42	9
Net income (loss) (2)	13	27	25	(84 )
Basic earnings (loss) per share (1)	\$0.09	\$ 0.19	\$ 0.18	\$ (0.60 )
Diluted earnings (loss) per share (1)	\$0.09	\$ 0.19	\$ 0.18	\$ (0.60 )

(1) Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share may not equal the total computed for the year.

During the fourth quarter of 2017, we recognized \$67 million of Transition Tax and \$6 million of tax expense (2) recorded for the remeasurement of our net deferred tax assets related to the 2017 Tax Act enacted on December 22, 2017. Refer to "Note 11: Income Taxes" for further information.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

## Evaluation of Disclosure Controls and Procedures

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

As of December 31, 2018, our management, with the participation of our Chief Executive Officer and President and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based upon that evaluation, our Chief Executive Officer and President and our Chief Financial Officer concluded that, as of December 31, 2018, our disclosure controls and procedures were effective in ensuring that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's, or the SEC's, rules and forms, including ensuring that such material information is accumulated and communicated to our management, including our Chief Executive Officer and President and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting that occurred during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and President and the Chief Financial Officer, the Company conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria for effective internal control over financial reporting described in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Company's management evaluated the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. Pursuant to Exchange Act Rule 13a-15(d) or 15d-15(d), management has concluded that, as of December 31, 2018, our internal control over financial reporting was effective. Management has reviewed its assessment with the Audit Committee. KPMG LLP, an independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2018, as stated in their report which is included below.

## Limitations on Effectiveness of Controls and Procedures

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company have been detected.



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and board of directors  
TripAdvisor, Inc.:

### Opinion on Internal Control Over Financial Reporting

We have audited TripAdvisor, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated February 22, 2019 expressed an unqualified opinion on those consolidated financial statements.

### Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

Boston, Massachusetts

February 22, 2019

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required under this item is incorporated herein by reference to our 2019 Proxy Statement, which proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the close of our fiscal year ended December 31, 2018.

Item 11. Executive Compensation

The information required under this item is incorporated herein by reference to our 2019 Proxy Statement, which proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the close of our fiscal year ended December 31, 2018.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required under this item is incorporated herein by reference to our 2019 Proxy Statement, which proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the close of our fiscal year ended December 31, 2018.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required under this item is incorporated herein by reference to our 2019 Proxy Statement, which proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the close of our fiscal year ended December 31, 2018.

Item 14. Principal Accounting Fees and Services

The information required under this item is incorporated herein by reference to our 2019 Proxy Statement, which proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the close of our fiscal year ended December 31, 2018.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules

(a) The following is filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements: The consolidated financial statements and report of independent registered public accounting firms required by this item are included in Part II, Item 8.
- All other schedules are omitted because they are not applicable or not required, or because the required information is shown either in the consolidated financial statements or in the notes thereto.

## (b) Exhibits:

Exhibit		Incorporated by Reference			
No.	Exhibit Description	Filed Here with Form	SEC File No.	Exhibit No.	Filing Date
3.1	<u>Restated Certificate of Incorporation of TripAdvisor, Inc.</u>	8-K	001-35362	3.1	12/27/11
3.2	<u>Amended and Restated Bylaws of TripAdvisor, Inc.</u>	8-K	001-35362	3.2	12/27/11
3.3	<u>Amended No. 1 to Amended and Restated Bylaws of TripAdvisor, Inc.</u>	8-K	001-35362	3.1	2/12/13
4.1	<u>Specimen TripAdvisor, Inc. Common Stock Certificate</u>	S-4/A	333-175828-04	4.6	10/24/11
10.1	<u>Governance Agreement, by and among TripAdvisor, Inc., Liberty Interactive Corporation and Barry Diller, dated as of December 20, 2011</u>	8-K	001-35362	10.1	12/27/11
10.2	<u>Tax Sharing Agreement by and between TripAdvisor, Inc. and Expedia, Inc., dated as of December 20, 2011</u>	8-K	001-35362	10.2	12/27/11
10.3+	<u>Amended and Restated TripAdvisor, Inc. 2011 Stock and Annual Incentive Plan</u>	10-Q	001-35362	10.1	11/8/16
10.4+	<u>TripAdvisor, Inc. 2018 Stock and Annual Incentive Plan</u>	10-Q	001-35362	10.1	8/1/18
10.5+	<u>TripAdvisor, Inc. Deferred Compensation Plan for Non-Employee Directors</u>	S-8	333-178637	4.6	12/20/11
10.6	<u>Corporate Headquarters Lease with Normandy Gap-V Needham Building 3, LLC, as landlord, dated as of June 20, 2013</u>	10-Q	001-35362	10.1	7/24/13
10.7	<u>Guaranty dated June 20, 2013 by TripAdvisor, Inc. for the benefit of Normandy Gap-V Needham Building 3, LLC, as landlord</u>	10-Q	001-35362	10.2	7/24/13
10.8+	<u>Employment Agreement between TripAdvisor LLC and Seth Kalvert, effective as of May 19, 2016</u>	8-K	001-35362	10.1	5/23/16
10.9+	<u>Amendment to Employment Agreement between TripAdvisor LLC and Seth Kalvert, dated as of February 19, 2018</u>	10-K	001-35362	10.8	2/21/18
10.10+	<u>Employment Agreement between TripAdvisor LLC and Stephen Kaufer, effective as of March 31, 2014</u>	10-Q	001-35362	10.3	5/6/14
10.11+	<u>Amendment to Employment Agreement between TripAdvisor LLC and Stephen Kaufer, effective as of November 28, 2017</u>	10-K	001-35362	10.10	2/21/18
10.12+	<u>Amended and Restated Option Agreement dated June 5, 2017 between Stephen Kaufer and TripAdvisor, Inc.</u>	8-K	001-35362	10.1	6/8/17
10.13+	<u>Stock Option Agreement (time-based) between Stephen Kaufer and TripAdvisor, Inc. dated November 28, 2017</u>	10-K	001-35362	10.12	2/21/18
10.14+	<u>RSU Agreement (time-based) between Stephen Kaufer and TripAdvisor, Inc. dated November 28, 2017</u>	10-K	001-35362	10.13	2/21/18

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de

10.15+ RSU Agreement (performance based (market)) between 10-K 001-35362 10.14 2/21/18  
Stephen Kaufer and TripAdvisor, Inc. dated November 28,  
2017

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Exhibit No.	Exhibit Description	Filed Here with Form	Incorporated by Reference		
			SEC File No.	Exhibit No.	Filing Date
10.16+	<u>RSU Agreement (performance based (financial and strategic)) between Stephen Kaufer and TripAdvisor, Inc. dated November 28, 2017</u>	10-K	001-35362	10.15	2/21/18
10.17+	<u>Viator, Inc. 2010 Stock Incentive Plan</u>	S-8	333-198726	99.1	9/12/14
10.18+	<u>Offer Letter dated May 9, 2017, between TripAdvisor Limited and Dermot Halpin</u>	10-Q	001-35362	10.1	5/9/17
10.19	<u>Credit Agreement dated as of June 26, 2015 by and among TripAdvisor, Inc., TripAdvisor Holdings, LLC, TripAdvisor LLC, JPMorgan Chase Bank, N.A., as Administrative Agent; J.P. Morgan Europe Limited, as London Agent; Morgan Stanley Bank, N.A.; Bank of America, N.A.; BNP Paribas; SunTrust Bank; Wells Fargo Bank, National Association; Royal Bank of Canada; Barclays Bank PLC; U.S. Bank National Association; Citibank, N.A.; The Bank of Tokyo-Mitsubishi UFJ, Ltd.; Goldman Sachs Bank USA; and Deutsche Bank AG New York Branch</u>	8-K	001-35362	10.1	6/30/15
10.20	<u>First Amendment, dated as of May 12, 2017, by and among TripAdvisor, Inc., TripAdvisor Holdings, LLC, TripAdvisor LLC and other Subsidiary Loan Parties party thereto, the Lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, and J.P.Morgan Europe Limited, as London Agent</u>	8-K	001-35362	10.1	5/15/17
10.21+	<u>Employment Agreement, dated as of October 6, 2015, between TripAdvisor, LLC and Ernst Teunissen</u>	8-K	001-35362	10.1	10/8/15
10.22+	<u>Amendment to Employment Agreement, dated as of November 28, 2017, between TripAdvisor, LLC and Ernst Teunissen</u>	10-K	001-35362	10.21	2/21/18
10.23+	<u>Executive Severance Plan and Summary Plan Description</u>	10-Q	001-35362	10.4	8/8/17
10.24	<u>Form of TripAdvisor Media Group Master Advertising Insertion Order</u>	10-K	001-35362	10.23	2/21/18
10.25+	<u>Form of Option Agreement (Domestic)</u>	10-Q	001-35362	10.1	5/8/18
10.26+	<u>Form of Option Agreement (International)</u>	10-Q	001-35362	10.2	5/8/18
10.27+	<u>Form of Restricted Stock Unit Agreement (Domestic)</u>	10-Q	001-35362	10.3	5/8/18
10.28+	<u>Form of Restricted Stock Unit Agreement (International)</u>	10-Q	001-35362	10.4	5/8/18
10.29+	<u>Form of Restricted Stock Unit Agreement (French)</u>	10-Q	001-35362	10.5	5/8/18
10.30+	<u>Form of Restricted Stock Unit Agreement (Performance Based Domestic)</u>	10-Q	001-35362	10.6	5/8/18
10.31+	<u>Form of Restricted Stock Unit Agreement (Performance Based French)</u>	10-Q	001-35362	10.7	5/8/18
10.32+	<u>Form of Restricted Stock Unit Agreement (Non-Employee Directors)</u>	10-Q	001-35362	10.2	8/1/18
21.1	<u>Subsidiaries of the Registrant</u>	X			

Warrants may be classified as assets or liabilities (derivative accounting), temporary equity, or permanent equity, de



- |      |  |   |
|------|--|---|
| 23.1 | <u>Consent of KPMG, LLP, Independent Registered Public Accounting Firm</u> | X |
| 24.1 | <u>Power of Attorney (included in signature page)</u>                      | X |

Exhibit		Incorporated by Reference SEC			
No.	Exhibit Description	Filed Herewith	Form	File No.	Exhibit No.
31.1	<u>Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	X			
31.2	<u>Certification of the Chief Financial Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002</u>	X			
32.1	<u>Certification of the Chief Executive Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002</u>	X			
32.2	<u>Certification of the Chief Financial Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002</u>	X			
101	The following financial statements from the Company's Annual Report on Form 10-K for the year ended December 31, 2018, formatted in XBRL: (i) Consolidated Statements of Operations, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.	X			
+ Indicates a management contract or a compensatory plan, contract or arrangement.					

Item 16. Form 10-K Summary  
Not applicable.

Signatures

Pursuant to the requirements of the Section 13 or 15(d) of Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TRIPADVISOR, INC.

By: /s/ STEPHEN KAUFER  
February 22, 2019 Stephen Kaufer

Chief Executive Officer and President

POWER OF ATTORNEY

We, the undersigned officers and directors of TripAdvisor, Inc., hereby severally constitute and appoint Stephen Kaufer and Ernst Teunissen, and each of them singly, our true and lawful attorneys, with full power to them and each of them singly, to sign for us in our names in the capacities indicated below, all amendments to this report, and generally to do all things in our names and on our behalf in such capacities to enable TripAdvisor, Inc. to comply with the provisions of the Securities Exchange Act of 1934, as amended, and all requirements of the Securities and Exchange Commission.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated as of February 22, 2019.

Signature	Title
/s/ STEPHEN KAUFER	Chief Executive Officer, President and Director
Stephen Kaufer	(Principal Executive Officer)
/s/ ERNST TEUNISSEN	Chief Financial Officer
Ernst Teunissen	(Principal Financial Officer)
/s/ NOEL WATSON	Chief Accounting Officer
Noel Watson	(Principal Accounting Officer)
/s/ GREGORY B. MAFFEI	Chairman of the Board
Gregory B. Maffei	

/s/ JAY C. HOAG                      Director  
Jay C. Hoag

/s/ DIPCHAND V. NISHAR           Director  
Dipchand V. Nishar

/s/ JEREMY PHILIPS                Director  
Jeremy Philips

/s/ SPENCER M. RASCOFF          Director  
Spencer M. Rascoff

/s/ ALBERT E. ROSENTHALER      Director  
Albert E. Rosenthaler

/s/ ROBERT S. WIESENTHAL       Director  
Robert S. Wiesenthal