HouseValues, Inc.
Form 10-Q
November 03, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**
For The Quarter Ended September 30, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**
Commission File Number: 000-51032

HouseValues, Inc.

(Exact name of registrant as specified in its charter)

Washington	**91-1982679**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

11332 NE 122nd Way, Kirkland, WA 98034

(Address of principal executive offices, including zip code)

(425) 952-5500

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of October 20, 2006, there were outstanding 24,358,400 shares of the registrant s common stock, $0.001 par value, which is the only class of common stock of the registrant.

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Item 1. Condensed Consolidated Financial Statements

HouseValues, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Revenues	$ 23,985	$ 23,337	$ 76,722	$ 61,533
Expenses:				
Sales and marketing (1)	17,303	11,556	49,948	30,582
Technology and product development (1)	3,389	1,823	10,421	4,958
General and administrative (1)	3,813	3,375	11,254	9,321
Depreciation and amortization of property and equipment (2)	1,559	506	3,689	1,262
Amortization of intangible assets	258	151	1,063	454
Total expenses	26,322	17,411	76,375	46,577
(Loss) Income from operations	(2,337)	5,926	347	14,956
Interest income, net	717	491	2,011	1,295
(Loss) Income before income tax (benefit) expense	(1,620)	6,417	2,358	16,251
Income tax (benefit) expense	(157)	2,086	157	5,282
Net (loss) income	$ (1,463)	$ 4,331	$ 2,201	$ 10,969
Net (loss) income per share:				
Basic	$ (0.06)	$ 0.17	$ 0.09	$ 0.43
Diluted	$ (0.06)	$ 0.16	$ 0.08	$ 0.40

(1) Stock-based compensation is included in the expense line items above in the following amounts:

	2006	2005	2006	2005
Sales and marketing	$ 218	$ 57	$ 798	$ 185
Technology and product development	176	42	578	121
General and administrative	562	175	1,728	523
	$ 956	$ 274	$ 3,104	$ 829

(2) Depreciation and amortization of property and equipment is allocated as follows:

	2006	2005	2006	2005
Technology and product development	$ 1,034	$ 199	$ 2,154	$ 430
General and administrative	525	307	1,535	832
	$ 1,559	$ 506	$ 3,689	$ 1,262

See accompanying notes to condensed consolidated financial statements.

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HouseValues, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(unaudited)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 50,334	$ 59,234
Short-term investments	28,575	25,640
Accounts receivable, net of allowance of $177 and $242	474	577
Prepaid expenses and other assets	1,541	1,700
Deferred income taxes	1,567	258
Prepaid income taxes	1,278	997
Other current assets	96	579
Total current assets	83,865	88,985
Property and equipment, net of accumulated depreciation of $7,376 and $3,689	12,461	11,118
Goodwill	6,815	6,227
Intangible assets, net of accumulated amortization of $3,066 and $2,003	3,799	4,853
Other noncurrent assets	408	408
Total assets	$ 107,348	$ 111,591
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 1,308	$ 1,030
Accrued compensation and benefits	3,574	4,236
Accrued expenses and other current liabilities	5,087	6,529
Deferred rent, current portion	289	289
Deferred revenue	1,554	1,694
Total current liabilities	11,812	13,778
Deferred income taxes	969	726
Deferred rent, less current portion	1,180	1,423
Note payable	1,709	1,600
Total liabilities	15,670	17,527
Shareholders equity:		
Common stock, par value $0.001 per share, stated at amounts paid in; authorized 120,000,000 shares; issued and outstanding 24,611,795 and 25,783,980 shares at September 30, 2006 and December 31, 2005	63,901	71,385
Deferred stock-based compensation		(2,897)
Retained earnings	27,777	25,576
Total shareholders equity	91,678	94,064
Total liabilities and shareholders equity	$ 107,348	$ 111,591

See accompanying notes to condensed consolidated financial statements.

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HouseValues, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine months ended September 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 2,201	$ 10,969
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	3,689	1,262
Amortization of intangible assets	1,063	454
Stock-based compensation	3,104	829
Deferred income tax benefit	(1,066)	(412)
Tax benefit from exercises of stock options		1,736
Changes in certain assets and liabilities		
Accounts receivable	103	(209)
Prepaid expenses and other assets	287	(129)
Prepaid income taxes	(188)	
Other current assets	483	1,521
Accounts payable	118	(197)
Accrued compensation and benefits	(662)	1,318
Accrued expenses and other current liabilities	1,282	2,116
Deferred rent	(243)	107
Deferred revenue	(140)	441
Income taxes payable and other	109	39
Net cash provided by operating activities	10,140	19,845
Cash flows from investing activities:		
Purchases of short-term investments	(5,000)	(12,799)
Sales of short-term investments	2,065	4,300
Purchases of property and equipment	(7,235)	(4,984)
Additions to goodwill and intangible assets	(1,335)	(1,155)
Net cash used in investing activities	(11,505)	(14,638)
Cash flows from financing activities:		
Purchase and retirement of common stock	(9,107)	
Proceeds from exercises of stock options and warrants	1,070	848
Tax benefit from exercises of stock options	502	
Issuance costs related to the sale of common stock		(614)
Net cash (used in) provided by financing activities	(7,535)	234
Net (decrease) increase in cash and cash equivalents	(8,900)	5,441
Cash and cash equivalents at beginning of period	59,234	57,562
Cash and cash equivalents at end of period	$ 50,334	$ 63,003

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands except per share amounts)

(unaudited)

Note 1: Summary of Significant Accounting Policies

Nature of Operations

Founded in 1999, HouseValues Inc. provides consumers and real estate professionals with the information and tools they need for success throughout the home buying and selling process. The company s flagship consumer products include HomePages.com , a lifestyle and neighborhood-centric home buying and selling service; TheLoanPage.com, a service that provides current and prospective home owners with competitive mortgage and refinance quotes from leading lenders; HouseValues.com®, a service that provides home sellers with market valuations of their current home; and JustListed.com , a service that alerts home buyers as soon as new homes hit the market that meet their criteria.

Basis of Presentation

The condensed consolidated financial statements are unaudited and include the financial statements of HouseValues, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements included in our 2005 Annual Report on Form 10-K. All adjustments necessary for the fair presentation of our results of operations, financial position and cash flows have been included and are of a normal, recurring nature. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of results to be expected for a full year.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Reclassifications

Prior period financial statement amounts have been reclassified to conform to current period presentation.

Summary of significant accounting policies

The significant accounting policies used in the preparation of our consolidated financial statements are disclosed in our 2005 Annual Report on Form 10-K. Updates to our significant accounting policies for 2006 are disclosed below.

Stock-based Compensation

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (Revised 2004) (FAS 123R), which requires the measurement and recognition of compensation for all stock-based awards made to employees and directors based on estimated fair values. FAS 123R supersedes previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees for periods beginning in 2006.

We adopted FAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. In accordance with the modified prospective transition method, our consolidated financial statements for periods prior to 2006 have not been restated to reflect this change.

Prior to our adoption of FAS 123R, we determined our stock-based compensation expense under the intrinsic value method on a straight-line basis over the vesting period of the options. With the adoption of FAS 123R, this expense has been replaced with stock-based compensation expense determined under the fair value method. Additionally, the deferred compensation in the equity section of our balance sheet has been reclassified to our common stock account.

Stock-based compensation recognized during the current year periods is based on the value of the portion of our stock-based awards earned over that service period, adjusted for expected forfeitures. Stock-based compensation recognized in our 2006 financial statements includes compensation cost for stock-based awards granted prior to, but not fully vested as of December 31, 2005 and additional stock-based awards granted subsequent to December 31, 2005.

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The compensation cost for awards granted prior to 2006 is based on the grant date fair value estimated in accordance with the pro forma provisions of FAS 123 while awards granted in 2006 follow the provisions of FAS 123R to determine the grant date fair value and compensation cost. Compensation cost for all stock-based awards is recognized using the straight-line method.

Upon adoption of FAS 123R, we continue to use the Black-Scholes option pricing model as our method of valuation for stock-based awards. Our determination of the fair value of stock-based awards on the date of grant using this option pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected life of the award, our expected stock price volatility over the expected life of the award and projected exercise behaviors. Although the fair value of stock-based awards is determined in accordance with FAS 123R, the Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued FAS 123R which requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, such as stock options granted to employees. We adopted FAS 123R during the first quarter of 2006. We have elected to apply FAS 123R on a modified prospective method. Under this method, we apply the fair value method in 2006 and do not restate prior periods. Further, compensation expense for existing grants is recorded for the unvested portion of the fair value compensation expense of those grants over the remaining vesting periods. Stock-based compensation expense has increased substantially from what we have historically disclosed as pro forma compensation expense under the fair value method due to the increased number of option grants issued and the increase in the average option fair value. Also, FAS 123R requires us to change the classification of the tax savings resulting from tax deductions in excess of expense reflected in our financial statements from an operating cash flow to a financing cash flow, impacting our cash flows from operating activities.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements. FIN 48 requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. We will implement this Interpretation in the first quarter of 2007. We are currently evaluating the potential impact this Interpretation will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which provides guidance on how to measure assets and liabilities that use fair value. SFAS 157 will apply whenever another US GAAP standard requires assets or liabilities to be measured at fair value but does not expand the use of fair value to any new circumstances. This standard also will require additional disclosures in both annual and quarterly reports. SFAS 157 will be adopted by us beginning in the first quarter of 2008. We are currently evaluating the potential impact this standard may have on our financial position and results of operations, but do not believe the impact of the adoption will be material.

Note 2: Acquisitions

The Loan Page

In October 2005 we acquired the outstanding stock of The Loan Page, Inc. The Loan Page generates and markets mortgage leads primarily to mortgage lenders, including some of the nation s largest banking and lending institutions. The company was purchased for approximately $5,247 in cash, assumption of a note payable valued at $1,590, as well as its remaining liabilities. We also incurred $147 in transaction costs.

As part of that acquisition we assumed a note payable with a face amount of $1,680 and a contractual interest rate of 3.55%. Upon acquisition, the note was discounted to a fair value of $1,590 to reflect an effective yield of 8.2%. The note requires all principal and interest be paid in full on December 22, 2008, a total payment of $2,000.

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The assets and liabilities acquired in The Loan Page acquisition were assigned the following values at the date of acquisition:

	October 31, 2005 (Date of Acquisition)