HOMESTORE INC
Form 10-Q
May 05, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended March 31, 2006**
or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to _______**
Commission File Number 000-26659

Homestore, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**95-4438337**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
30700 Russell Ranch Road Westlake Village, California	**91362**
(Address of Principal Executive Offices)	*(Zip Code)*

(805) 557-2300
(Registrant s Telephone Number, including Area Code:)

Indicate by check mark whether 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 þ No o

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. (Check one):

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

At May 1, 2006, the registrant had 150,445,819 shares of its common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

HOMESTORE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2006 (Unaudited)		December 31, 2005	
	(In thousands)			
ASSETS				
Current assets:				
Cash and cash equivalents	$	18,127	$	13,272
Short-term investments		124,575		139,050
Accounts receivable, net		16,984		15,966
Other current assets		19,183		19,485
Total current assets		178,869		187,773
Property and equipment, net		25,516		20,717
Goodwill, net		23,877		19,502
Intangible assets, net		17,997		14,264
Restricted cash		4,122		5,026
Other assets		1,568		1,744
Total assets	$	251,949	$	249,026
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	4,627	$	6,427
Accrued expenses		27,517		40,879
Obligation under capital leases		2,080		1,005
Deferred revenue		53,158		43,652
Total current liabilities		87,382		91,963
Obligation under capital leases		2,931		
Other liabilities		3,668		3,790
Total liabilities		93,981		95,753
Commitments and contingencies (see note 11)				
Series B convertible preferred stock		92,523		91,349
Stockholders equity:				
Series A convertible preferred stock				

Common stock	150	149
Additional paid-in capital	2,052,960	2,047,456
Deferred stock-based charges		(351)
Accumulated other comprehensive income	341	343
Accumulated deficit	(1,988,006)	(1,985,673)
Total stockholders equity	65,445	61,924
Total liabilities and stockholders equity	$ 251,949	$ 249,026

The accompanying notes are an integral part of these unaudited
Condensed Consolidated Financial Statements.

HOMESTORE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In thousands, except per share amounts) (Unaudited)	
Revenue	$ 68,979	$ 56,456
Cost of revenue	16,406	12,901
Gross profit	52,573	43,555
Operating expenses:		
Sales and marketing	25,341	22,362
Product and web site development	8,355	4,379
General and administrative	20,976	16,377
Amortization of intangible assets	747	1,197
Total operating expenses	55,419	44,315
Loss from operations	(2,846)	(760)
Interest income, net	1,615	353
Other income, net	72	12
Net loss	(1,159)	(395)
Convertible preferred stock dividend	(878)	
Net loss applicable to common stockholders	$ (2,037)	$ (395)
Unrealized loss on marketable securities		(37)
Foreign currency translation	(2)	(2)
Comprehensive loss	$ (2,039)	$ (434)
Basic and diluted loss per share applicable to common stockholders (see note 8)	$ (0.01)	$ (0.00)

Shares used to calculate basic and diluted net loss per share applicable to common stockholders:		
Basic and diluted	148,951	146,656

The accompanying notes are an integral part of these unaudited
Condensed Consolidated Financial Statements.

HOMESTORE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended March 31, 2006	Three months ended March 31, 2005
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net loss	$ (1,159)	$ (395)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	2,444	1,624
Amortization of intangible assets	747	1,197
Provision for doubtful accounts	173	375
Stock-based compensation and charges	3,511	384
Other non-cash items	1	(53)
Changes in operating assets and liabilities:		
Accounts receivable	305	(36)
Other assets	454	(2,257)
Accounts payable and accrued expenses	(15,539)	(4,348)
Deferred revenue	8,659	7,987
Net cash provided by (used in) operating activities	(404)	4,478
Cash flows from investing activities:		
Purchases of property and equipment	(2,513)	(1,546)
Maturities of short term investments	16,075	
Purchases of short term investments	(1,600)	(285)
Acquisitions, net	(9,572)	
Net cash provided by (used in) investing activities	2,390	(1,831)
Cash flows from financing activities:		
Proceeds from exercise of stock options	2,414	470
Restricted cash	904	(21)
Payments on capital lease obligations	(449)	(332)
Net cash provided by financing activities	2,869	117
Change in cash and cash equivalents	4,855	2,764
Cash and cash equivalents, beginning of period	13,272	14,819

Cash and cash equivalents, end of period	$ 18,127	$ 17,583

The accompanying notes are an integral part of these unaudited
Condensed Consolidated Financial Statements.

HOMESTORE, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business

Homestore, Inc. dba Move (Homestore or the Company) has created an online service that enables consumers to find real estate listings and other content related to residential real estate, moving and relocation. The Company s web sites collectively have become the leading consumer destination on the Internet for home and real estate-related information based on the number of visitors, time spent on its web sites and number of property listings. The Company generates most of its revenue from selling advertising and marketing solutions to both real estate industry participants, including real estate agents, homebuilders and rental property owners, and other local and national advertisers interested in reaching the Company s consumer audience (before, during or after a move). The Company also provides software solutions to real estate agents to assist them in managing their client interactions and architects home plans to consumers considering building a new home. The Company derives all of its revenue from its North American operations.

The Company s primary consumer web sites include REALTOR.com®, the official site of the National Association of REALTORS® (NAR); HomeBuilder.com®, the official new home listing site of the National Association of Homebuilders (NAHB); RENTNET®, an apartment, corporate housing and self-storage resource; SeniorHousingNet ™ .com, a comprehensive resource for seniors; Moving.com ™ which connects consumers with moving companies, van lines, truck rental providers and self storage facilities; and Homestore.com®, a home information resource site with an emphasis on content related to mortgage financing, moving and storage, and home and garden activities. During the second quarter of 2006, the Company intends to launch Move.com ™ as a real estate listing and move-related search site. Shortly after its launch, Move.com ™ will replace HomeBuilder.com®, RENTNET® and Homestore.com® and the Company will begin promoting those services under the MOVE brand.

2. Basis of Presentation

The Company s unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) including those for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X issued by the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and note disclosures required by GAAP for complete financial statements. These statements are unaudited and, in the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary for a fair presentation have been included. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s Form 10-K for the year ended December 31, 2005, which was filed with the SEC on March 13, 2006. The results of operations for these interim periods are not necessarily indicative of the operating results for a full year.

3. Significant Accounting Policy

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment, (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options based on estimated fair values. SFAS 123R supersedes the Company s previous accounting under Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB 25) for periods beginning in fiscal 2006. In March 2005, the SEC issued Staff Accounting Bulleting No. 107 (SAB 107) related to SFAS 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company s fiscal year 2006. The Company s Consolidated Financial Statements as of and for the three months ended March 31, 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect and do not include the impact of SFAS 123R. Stock-based compensation expense recognized under SFAS 123R for the three months ended March 31, 2006 was $3.4 million related to employee stock options.

Prior to January 1, 2006, the Company accounted for stock options granted in accordance with the provisions and related interpretations of APB 25 as permitted by SFAS 123. Therefore, there was no stock-based compensation related to employee stock options for the three months ended March 31, 2005. See Note 7 for additional information.

4. Restructuring Charges

The Company has taken four restructuring charges: in the fourth quarter of 2001, the first quarter of 2002, the third quarter of 2002 and the fourth quarter of 2003. All of these charges were a part of plans approved by the Company s Board of Directors, with the objective of eliminating duplicate resources and redundancies. The Company has also revised previous estimates from time to time.

A summary of activity in 2005 and 2006 related to the four restructuring charges and the changes in the Company s estimates is as follows (in thousands):

	Employee Termination Benefits	Lease Obligations and Related Charges	Contractual Obligations	Total
Restructuring accrual at January 1, 2005	$ 21	$ 8,404	$ 401	$ 8,826
Cash paid		(859)	(4)	(863)
Restructuring accrual at March 31, 2005	21	7,545	397	7,963
Cash paid		(941)	(1)	(942)
Change in estimates	(21)	(1,370)	(51)	(1,442)
Restructuring accrual at June 30, 2005		5,234	345	5,579
Cash paid		(900)	(4)	(904)
Change in estimates		52	(52)	
Restructuring accrual at September 30, 2005		4,386	289	4,675
Cash paid		(986)		(986)
Change in estimates		155	(44)	111
Restructuring accrual at December 31, 2005		3,555	245	3,800
Cash paid		(882)	(11)	(893)
Change in estimates				
Restructuring accrual at March 31, 2006	$	$ 2,673	$ 234	$ 2,907

Substantially all of the remaining restructuring liabilities at March 31, 2006 will be paid by the end of fiscal year 2006. Any further changes to the accruals based upon current estimates will be reflected through the restructuring charges line in the Consolidated Statement of Operations.

5. Goodwill and Other Intangible Assets

Goodwill, net, by segment, as of March 31, 2006 and December 31, 2005 is as follows (in thousands):

	March 31, 2006	December 31, 2005
Real Estate Services	$ 12,988	$ 12,988
Move-Related Services	10,889	6,514
Total	$ 23,877	$ 19,502

Definite-lived intangible assets consist of purchased content, portal relationships, purchased technology, and other miscellaneous agreements entered into in connection with business combinations and are amortized over expected periods of benefits. The only indefinite lived intangibles are certain trade and domain names. There are no expected residual values related to these intangible assets (in thousands):

	March 31, 2006		December 31, 2005	
	Gross Amount	**Accumulated Amortization**	**Gross Amount**	**Accumulated Amortization**
Trade and domain names, trademarks, websites and brand names	$ 21,746	$ 7,234	$ 19,746	$ 6,902
Purchased technology	10,499	9,116	9,099	9,099
NAR operating agreement	1,578	639	1,578	601
Other	7,381	6,218	6,301	5,858
Total	$ 41,204	$ 23,207	$ 36,724	$ 22,460

Amortization expense for intangible assets for the three months ended March 31, 2006 and 2005 was $747,000 and $1.2 million, respectively. Amortization expense for the next five years is estimated to be as follows (in thousands):

Years Ended December 31,	**Amount**
2006 (remaining 9 months)	$ 1,583
2007	1,990
2008	1,963
2009	1,687
2010	1,620

6. Stock-Based Charges

Prior to the adoption of SFAS 123R, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of APB 25, and complied with the disclosure provisions of SFAS 123. Under APB 25, compensation expense is recognized over the vesting period based on the difference, if any, on the date of grant between the deemed fair value for accounting purposes of the Company s stock and the exercise price on the date of grant.

The Company granted restricted stock awards to members of its board of directors as compensation in 2003, 2004 and 2005. These shares will vest on the third anniversary of issuance. As of March 31, 2006 and 2005, there were 372,700 and 574,460 unvested shares of restricted stock issued to members of the Company s board of directors.

Prior to the adoption of SFAS 123R on January 1, 2006, the intrinsic value of restricted stock awards granted to the Company s board of directors were recorded as deferred compensation. Upon adoption of SFAS 123R, the deferred compensation balance of approximately $351,000 was reclassified to additional-paid-in-capital.

The Company has granted restricted stock awards to its Chief Executive Officer in consideration for his service in 2003, 2004 and 2005. These shares will vest on the third anniversary of their issuance. As of March 31, 2006 and 2005, there were 186,662 and 70,922 unvested shares of restricted stock issued to the Company s Chief Executive Officer. The intrinsic value of these restricted stock awards were included in the results of operations in the period in which they were granted.

The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services.

The following chart summarizes the stock-based charges that have been included in the following captions for each of the periods presented (in thousands):

	Three Months Ended March 31,	
	2006	**2005**
Sales and marketing	$ 68	$ 75
General and administrative	73	309
Total	$ 141	$ 384

Stock-based charges included in sales and marketing represent costs related to vendor agreements and charges included in general and administrative represent amortization of restricted stock.

7. Stock-Based Compensation

In general, options granted by the Company are vested over a four year period and are granted at fair market value at the date of grant. The life of an option grant cannot exceed ten years. In January 1999, the Board of Directors adopted, and in March 1999 the Company s stockholders approved, the 1999 Equity Incentive Plan (1999 Plan) to replace a pre-existing stock option plan (1996 Plan). The 1999 Plan provides for the issuance of both non-statutory and incentive stock options to employees, officers, directors and consultants of the Company. The initial number of shares of common stock reserved for issuance under the 1999 Plan was 10,000,000. In April 1999 and June 1999, the Board of Directors authorized, and the stockholders approved, an increase in the number of shares reserved for issuance under the 1999 Plan by an additional 3,000,000 shares and 625,000 shares, respectively.

In June 1999, the Board of Directors adopted, and the stockholders approved, the 1999 Stock Incentive Plan (SIP). The SIP reserves 4,900,000 shares of common stock for future grants. The SIP contains a provision for an automatic increase in the number of shares available for grant starting January 1, 2000 and each January thereafter by an amount equal to 4.5% of the outstanding shares as of the preceding December 31; provided, however, that the aggregate number of shares that qualify as Incentive Stock Options (as defined by the plan) must not exceed 20 million shares. In accordance with the provisions of the SIP, the number of options available for grant was increased by 6,713,966, 6,608,957 and 5,439,240 shares in January 2006, 2005 and 2004, respectively. Pursuant to the terms of the plan, no person is eligible to receive more than 2 million shares in any calendar year under the plan.

In connection with acquisitions prior to 2002, the Company assumed a total of 5,400,000 options. Options outstanding as of March 31, 2006, pursuant to compensation plans assumed in connection with prior acquisitions were 175,466.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R using the modified-prospective transition method. Under that transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to January 1, 2006, but not yet vested, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123; and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Compensation costs are recognized using a straight-line amortization method over the vesting period. Results for prior periods have not been restated.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions in the following table. Because the Black-Scholes option valuation model incorporates ranges of assumptions for input, those ranges are disclosed. Our computation of expected volatility is based on a combination of historical and market-based implied volatility. Due to the unusual volatility of the Company s stock price around the time of the restatement of its financial statements in 2002 and several historical acquisitions that changed the Company s risk profile, historical data was more heavily weighted toward the most recent two years of stock activity. The expected term of options granted was derived by averaging the vesting term with the contractual term. The risk-free interest rates are based on U.S. Treasury zero-coupon bonds for the periods in which the options were granted.

	Three Months Ended March 31, 2006
Risk-free interest rates	4.35-4.51%
Expected term (in years)	6.06
Dividend yield	0%
Expected volatility	80%

Net loss for the three months ended March 31, 2006, includes $3.4 million, or $0.02 per share of stock-based compensation expense. The following chart summarizes the stock-based compensation charges that have been included in the following captions for the three months ended March 31, 2006 (in thousands):

Cost of revenue	$ 129
Sales and marketing	489
Product and web site development	499
General and administrative	2,253
	$ 3,370

The following table illustrates the effect on net loss and net loss per share had the Company applied the fair value recognition provisions of SFAS 123 to stock options granted under the Company s equity-based compensation plans for the three months ended March 31, 2005. For the purposes of this pro forma disclosure, the grant-date fair value of the Company s stock options was estimated using a Black-Scholes option-pricing model and amortized over the stock-options vesting periods (in thousands, except per share amounts).

		Three Months Ended March 31, 2005
Net loss applicable to common stockholders:		
As reported	$	(395)

Add: Stock-based employee compensation charges included in reported net loss (1)		250
Deduct: Total stock-based compensation determined under the fair value-based method for all awards		(3,953)
Pro forma net loss	$	(4,098)
Net loss per share basic and diluted:		
As reported	$	(0.00)
Pro forma net loss	$	(0.03)

(1) Represents restricted stock compensation expense.

A summary of option activity under the plans as of March 31, 2006, and changes during the quarter then ended, is presented below (in thousands, except per share amounts):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 200				