Groupon, Inc.
Form 10-Q
May 09, 2018

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

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

OR

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: 1-35335

Groupon, Inc.
(Exact name of registrant as specified in its charter)

Delaware	27-0903295
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
600 West Chicago Avenue, Suite 400 Chicago, Illinois	60654
(Address of principal executive offices)	(Zip Code)

312-334-1579
(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 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 (§232.405 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 x No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.

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 May 7, 2018, there were 564,615,531 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our future results of operations and financial position, business strategy and plans and our objectives for future operations. The words "may," "will," "should," "could," "expect," "anticipate," "believe," "estimate," "intend," "continue" and other similar expressions are intended to identify forward-looking statements. We have based these forward looking statements largely on current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, but are not limited to, risk related to volatility in our operating results; execution of our business and marketing strategies; retaining existing customers and adding new customers; challenges arising from our international operations, including fluctuations in currency exchange rates, legal and regulatory developments and any potential adverse impact from the United Kingdom's likely exit from the European Union; retaining and adding high quality merchants; our voucherless offerings; cybersecurity breaches; competing successfully in our industry; changes to merchant payment terms; providing a strong mobile experience for our customers; maintaining our information technology infrastructure; delivery and routing of our emails; claims related to product and service offerings; managing inventory and order fulfillment risks; litigation; managing refund risks; retaining and attracting members of our executive team; completing and realizing the anticipated benefits from acquisitions, dispositions, joint ventures and strategic investments; lack of control over minority investments; tax liabilities; tax legislation; compliance with domestic and foreign laws and regulations, including the CARD Act, GDPR and regulation of the Internet and e-commerce; classification of our independent contractors; protecting our intellectual property; maintaining a strong brand; customer and merchant fraud; payment-related risks; our ability to raise capital if necessary and our outstanding indebtedness; global economic uncertainty; our common stock, including volatility in our stock price; our senior convertible notes; our ability to realize the anticipated benefits from the hedge and warrant transactions; and those risks and other factors discussed in Part I, Item 1A, Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2017, as well as in our condensed consolidated financial statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission, or the SEC. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. We do not intend, and undertake no obligation, to update any of our forward-looking statements after the date of this report to reflect actual results or future events or circumstances. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, "Groupon," "we," "our," and similar terms include Groupon, Inc. and its subsidiaries, unless the context indicates otherwise.

ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

GROUPON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	March 31, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$725,909	$880,129
Accounts receivable, net	81,571	98,294
Prepaid expenses and other current assets	89,282	94,025
Total current assets	896,762	1,072,448
Property, equipment and software, net	146,717	151,145
Goodwill	289,945	286,989
Intangible assets, net	16,925	19,196
Investments (including $103,579 and $109,751 at March 31, 2018 and December 31, 2017, respectively, at fair value)	129,373	135,189
Other non-current assets	23,206	12,538
Total Assets	$1,502,928	$1,677,505
Liabilities and Equity		
Current liabilities:		
Accounts payable	$23,400	$31,968
Accrued merchant and supplier payables	568,570	770,335
Accrued expenses and other current liabilities	265,920	331,196
Total current liabilities	857,890	1,133,499
Convertible senior notes, net	192,619	189,753
Other non-current liabilities	102,047	102,408
Total Liabilities	1,152,556	1,425,660
Commitments and contingencies (see Note 8)		
Stockholders' Equity		
Common stock, par value $0.0001 per share, 2,010,000,000 shares authorized; 752,664,286 shares issued and 564,062,044 shares outstanding at March 31, 2018; 748,541,862 shares issued and 559,939,620 shares outstanding at December 31, 2017	75	75
Additional paid-in capital	2,192,469	2,174,708
Treasury stock, at cost, 188,602,242 shares at March 31, 2018 and December 31, 2017	(867,450)	(867,450)
Accumulated deficit	(1,006,308)	(1,088,204)
Accumulated other comprehensive income (loss)	29,936	31,844
Total Groupon, Inc. Stockholders' Equity	348,722	250,973
Noncontrolling interests	1,650	872
Total Equity	350,372	251,845
Total Liabilities and Equity	$1,502,928	$1,677,505

See Notes to Condensed Consolidated Financial Statements.

GROUPON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Revenue:		
Service	$301,797	$301,577
Product	324,743	372,049
Total revenue	626,540	673,626
Cost of revenue:		
Service	31,145	42,873
Product	270,510	321,302
Total cost of revenue	301,655	364,175
Gross profit	324,885	309,451
Operating expenses:		
Marketing	99,156	86,342
Selling, general and administrative	222,061	232,058
Restructuring charges	283	2,731
Total operating expenses	321,500	321,131
Income (loss) from operations	3,385	(11,680)
Other income (expense), net	(8,515)	(4,602)
Income (loss) from continuing operations before provision (benefit) for income taxes	(5,130)	(16,282)
Provision (benefit) for income taxes	(2,335)	4,587
Income (loss) from continuing operations	(2,795)	(20,869)
Income (loss) from discontinued operations, net of tax	—	487
Net income (loss)	(2,795)	(20,382)
Net income attributable to noncontrolling interests	(4,093)	(4,032)
Net income (loss) attributable to Groupon, Inc.	$(6,888)	$(24,414)
Basic and diluted net income (loss) per share:		
Continuing operations	$(0.01)	$(0.04)
Discontinued operations	0.00	0.00
Basic and diluted net income (loss) per share	$(0.01)	$(0.04)
Weighted average number of shares outstanding		
Basic	561,735,937	562,195,243
Diluted	561,735,937	562,195,243

See Notes to Condensed Consolidated Financial Statements.

GROUPON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Income (loss) from continuing operations	$(2,795)	$(20,869)
Other comprehensive income (loss) from continuing operations:		
Net change in unrealized gain (loss) on foreign currency translations adjustments	(1,568)	430
Reclassification adjustments related to defined benefit pension plan	—	585
Net change in unrealized gain (loss) on available-for-sale securities (net of tax effect of $0 and $147 for the three months ended March 31, 2018 and 2017, respectively)	(501)	239
Other comprehensive income (loss) from continuing operations	(2,069)	1,254
Comprehensive income (loss) from continuing operations	(4,864)	(19,615)
Income (loss) from discontinued operations	—	487
Other comprehensive income (loss) from discontinued operations - Foreign currency translation adjustments:		
Net unrealized gain (loss) during the period	—	(1,793)
Reclassification adjustment included in net income (loss) from discontinued operations	—	(14,718)
Net change in unrealized gain (loss)	—	(16,511)
Comprehensive income (loss) from discontinued operations	—	(16,024)
Comprehensive income (loss)	(4,864)	(35,639)
Comprehensive income (loss) attributable to noncontrolling interests	(4,093)	(4,032)
Comprehensive income (loss) attributable to Groupon, Inc.	$(8,957)	$(39,671)

See Notes to Condensed Consolidated Financial Statements.

GROUPON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share amounts)
(unaudited)

	Groupon, Inc. Stockholders' Equity									
	Common Stock			Treasury Stock						
	Shares	Amount	Additional Paid-In Capital	Shares	Amount	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Groupon, Inc. Stockholders' Equity	Non-controlling Interests	T... E...
Balance at December 31, 2017	748,541,862	$75	$2,174,708	(188,602,242)	$(867,450)	$(1,088,204)	$31,844	$250,973	$872	$
Cumulative effect of change in accounting principle, net of tax	—	—	—	—	—	88,945	—	88,945	—	8
Reclassification for impact of U.S. tax rate change	—	—	—	—	—	(161)	161	—	—	–
Net income (loss)	—	—	—	—	—	(6,888)	—	(6,888)	4,093	(
Foreign currency translation	—	—	—	—	—	—	(1,568)	(1,568)	—	(
Unrealized gain (loss) on available-for-sale securities, net of tax	—	—	—	—	—	—	(501)	(501)	—	(
Exercise of stock options	2,400	—	6	—	—	—	—	6	—	6
Vesting of restricted stock units and performance share units	4,157,462	—	—	—	—	—	—	—	—	–
Shares issued under employee stock purchase plan	746,773	—	2,434	—	—	—	—	2,434	—	2
Shares issued to settle liability-classified awards	1,240,379	—	6,436	—	—	—	—	6,436	—	6
Tax withholdings related to net share settlements of stock-based compensation	(2,024,590)	—	(9,355)	—	—	—	—	(9,355)	—	(

awards										
Stock-based compensation on equity-classified awards	—	—	18,240	—	—	—	—	18,240	—	1
Distributions to noncontrolling interest holders	—	—	—	—	—	—	—	—	(3,315)	(
Balance at March 31, 2018	752,664,286	$75	$2,192,469	(188,602,242)	$(867,450)	$(1,006,308)	$29,936	$348,722	$1,650	$

See Notes to Condensed Consolidated Financial Statements.

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GROUPON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Operating activities		
Net income (loss)	$(2,795)	$(20,382)
Less: Income (loss) from discontinued operations, net of tax	—	487
Income (loss) from continuing operations	(2,795)	(20,869)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of property, equipment and software	26,721	28,667
Amortization of acquired intangible assets	2,940	5,400
Stock-based compensation	19,326	19,701
Deferred income taxes	(6,575)	(74)
(Gain) loss from changes in fair value of investments	5,033	(303)
Impairment of investment	855	—
Amortization of debt discount on convertible senior notes	2,866	2,587
Change in assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable	17,623	10,594
Prepaid expenses and other current assets	9,601	5,380
Accounts payable	(8,341)	(13,184)
Accrued merchant and supplier payables	(143,330)	(138,238)
Accrued expenses and other current liabilities	(41,564)	(36,040)
Other, net	(2,107)	(1,707)
Net cash provided by (used in) operating activities from continuing operations	(119,747)	(138,086)
Net cash provided by (used in) operating activities from discontinued operations	—	(1,098)
Net cash provided by (used in) operating activities	(119,747)	(139,184)
Investing activities		
Purchases of property and equipment and capitalized software	(20,144)	(14,076)
Acquisitions of intangible assets and other investing activities	(238)	56
Net cash provided by (used in) investing activities from continuing operations	(20,382)	(14,020)
Net cash provided by (used in) investing activities from discontinued operations	—	(7,547)
Net cash provided by (used in) investing activities	(20,382)	(21,567)
Financing activities		
Payments for purchases of treasury stock	—	(27,234)
Taxes paid related to net share settlements of stock-based compensation awards	(9,179)	(8,970)
Proceeds from stock option exercises and employee stock purchase plan	2,434	2,468
Distributions to noncontrolling interest holders	(3,315)	(3,450)
Payments of capital lease obligations	(9,024)	(8,067)
Payments of contingent consideration related to acquisitions	(1,815)	—
Other financing activities	—	(473)
Net cash provided by (used in) financing activities	(20,899)	(45,726)
Effect of exchange rate changes on cash, cash equivalents and restricted cash, including cash classified within current assets of discontinued operations	6,191	3,973
Net increase (decrease) in cash, cash equivalents and restricted cash, including cash classified within current assets of discontinued operations	(154,837)	(202,504)
Less: Net increase (decrease) in cash classified within current assets of discontinued operations	—	(28,866)

Net increase (decrease) in cash, cash equivalents and restricted cash	(154,837)	(173,638)
Cash, cash equivalents and restricted cash, beginning of period	885,481	874,906
Cash, cash equivalents and restricted cash, end of period	$730,644	$701,268
Non-cash investing and financing activities		
Continuing operations:		
Equipment acquired under capital lease obligations	1,470	1,340
Increase (decrease) in liabilities related to purchases of property and equipment and capitalized software	(1,022)	(1,185)
Investments acquired in connection with business dispositions	—	2,022

See Notes to Condensed Consolidated Financial Statements.

GROUPON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Company Information

Groupon, Inc. and subsidiaries (the "Company"), which commenced operations in October 2008, operates online local commerce marketplaces throughout the world that connect merchants to consumers by offering goods and services, generally at a discount. Customers access those marketplaces through the Company's websites, primarily localized groupon.com sites in many countries, and its mobile applications.

The Company's operations are organized into two segments: North America and International. See Note 15, Segment Information.

Unaudited Interim Financial Information

The Company has prepared the accompanying condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting. These condensed consolidated financial statements are unaudited and, in the Company's opinion, include all adjustments, consisting of normal recurring adjustments and accruals, necessary for a fair presentation of the Company's condensed consolidated balance sheets, statements of operations, comprehensive income (loss), cash flows and stockholders' equity for the periods presented. Operating results for the periods presented are not necessarily indicative of the results to be expected for the full year ending December 31, 2018. Certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") have been omitted in accordance with the rules and regulations of the SEC. These condensed consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 14, 2018, as amended by the Form 10-K/A for the year ended December 31, 2017, filed with the SEC on March 23, 2018.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The Company's condensed consolidated financial statements were prepared in accordance with U.S. GAAP and include the assets, liabilities, revenue and expenses of all wholly-owned subsidiaries and majority-owned subsidiaries over which the Company exercises control and variable interest entities for which the Company has determined that it is the primary beneficiary. Outside stockholders' interests in subsidiaries are shown on the condensed consolidated financial statements as Noncontrolling interests. Equity investments in entities in which the Company does not have a controlling financial interest are accounted for under the equity method, the fair value option, as available-for-sale securities or at cost adjusted for observable price changes and impairments, as appropriate.

Reclassifications and Terminology Changes

Certain reclassifications have been made to the condensed consolidated financial statements of prior periods and the accompanying notes to conform to the current period presentation, including the change in presentation of restricted cash in the condensed consolidated statements of cash flows upon adoption of ASU 2016-18. Refer to Note 2, Adoption of New Accounting Standards, for additional information. Additionally, in prior periods, the Company referred to its product revenue and service revenue as "direct revenue" and "third-party and other revenue," respectively. This terminology change did not impact the amounts presented in the condensed consolidated financial statements.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires estimates and assumptions that affect the reported amounts and classifications of assets and liabilities, revenue and expenses, and the related disclosures of contingent liabilities in the condensed consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, variable consideration from unredeemed vouchers, income taxes, valuation of goodwill and intangible assets, investments, customer refunds, contingent liabilities and the useful lives of property, equipment and software and intangible assets. Actual results could differ materially from those estimates.

2. ADOPTION OF NEW ACCOUNTING STANDARDS

The Company adopted the guidance in ASC Topic 606, Revenue from Contracts with Customers, on January 1, 2018. Topic 606 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. See Changes to Accounting Policies from Adoption of New Accounting Standards below and Note 10, Revenue Recognition, for information on the impact of adopting Topic 606 on the Company's accounting policies.

The Company adopted the guidance in ASU 2016-01, Financial Instruments (Topic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities, as amended, on January 1, 2018. This ASU generally requires equity investments to be measured at fair value with changes in fair value recognized through net income and eliminates the cost method for equity securities. However, for equity investments without readily determinable fair values the ASU permits entities to elect to measure the investments at cost adjusted for observable price changes and impairments, with changes in the measurement recognized through net income. We applied that measurement alternative to our equity investments that were previously accounted for under the cost method. The adoption of ASU 2016-01 did not have a material impact on the condensed consolidated financial statements. See Changes to Accounting Policies from Adoption of New Accounting Standards below for additional information on the impact of adopting the ASU on the Company's accounting policies.

The Company adopted the guidance in ASU 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash, on January 1, 2018. This ASU requires companies to include amounts generally described as restricted cash and restricted cash equivalents, along with cash and cash equivalents, when reconciling the beginning-of-period and end-of-period amounts shown on the statement of cash flows. Previously, changes in restricted cash were reported within cash flows from operating activities. The Company applied that change in cash flow classification on a retrospective basis, which resulted in an increase of $1.6 million to net cash used in operating activities for the three months ended March 31, 2017.

Restricted cash primarily represents amounts that the Company is unable to access for operational purposes pursuant to letters of credit with financial institutions. The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheet to amounts shown in the condensed consolidated statements of cash flows, as of March 31, 2018 and 2017 and December 31, 2017 (in thousands):

	March 31, 2018	March 31, 2017	December 31, 2017
Cash and cash equivalents	$725,909	$690,975	$880,129
Restricted cash included in prepaid expenses and other current assets	4,332	5,250	4,932
Restricted cash included in other non-current assets	403	5,043	420
Cash, cash equivalents and restricted cash	$730,644	$701,268	$885,481

The Company adopted the guidance in ASU 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) - Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets, on January 1, 2018. This ASU is meant to clarify the scope of ASC Subtopic 610-20, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets, and to add guidance for partial sales of nonfinancial assets. The adoption of ASU 2017-05 did not have a material impact on the condensed consolidated financial statements.

The Company adopted the guidance in ASU 2017-07, Compensation - Retirement Benefits (Topic 715) - Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, on January 1, 2018. This ASU requires employers to include only the service cost component of net periodic pension cost in operating expenses, together with other employee compensation costs. The other components of net periodic pension cost, including interest cost, expected return on plan assets, amortization of prior service cost and settlement and curtailment effects, are to be included in non-operating expenses. The adoption of ASU 2017-07 did not have a material impact on the condensed consolidated financial statements.

The Company adopted the guidance in ASU 2017-09, Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting, on January 1, 2018. This ASU clarifies the changes to terms or conditions of a share-based

payment award that require an entity to apply modification accounting. The adoption of ASU 2017-09 did not have a material impact on the condensed consolidated financial statements.
The Company adopted the guidance in ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, as of January 1, 2018. This ASU permits a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (the "Jobs Act"). As a result of the adoption of ASU 2018-02, the Company reclassified $0.2 million from accumulated other comprehensive income (loss) to accumulated deficit.
Changes to Accounting Policies from Adoption of New Accounting Standards
Revenue Recognition
Prior to its adoption of Topic 606, the Company recognized revenue when the following criteria were met: persuasive evidence of an arrangement existed; delivery had occurred; the selling price was fixed or determinable and collection was reasonably assured. Following its adoption of Topic 606, the Company recognizes revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. Substantially all of the Company's performance obligations are satisfied at a point in time rather than over time.
Product Revenue
The Company generates product revenue from direct sales of merchandise inventory through its Goods category. For product revenue transactions, the Company is the primary party responsible for providing the good to the customer, it has inventory risk and it has discretion in establishing prices. As such, product revenue is reported on a gross basis as the purchase price received from the customer. Product revenue, including associated shipping revenue, is recognized when title passes to the customer upon delivery of the product.
Service Revenue
Service revenue is primarily earned from transactions in which the Company earns commissions by selling goods or services on behalf of third-party merchants. Those transactions generally involve a customer's purchase of a voucher through one of the Company's online marketplaces that can be redeemed with a third-party merchant for specified goods or services (or for discounts on specified goods or services). Service revenue from those transactions is reported on a net basis as the purchase price collected from the customer less the portion of the purchase price that is payable to the third-party merchant. The Company recognizes revenue from those transactions when its commission has been earned, which occurs when a sale through one of the Company's online marketplaces is completed and the related voucher has been made available to the customer. The Company believes that its remaining obligations to remit payment to the merchant and to provide information about vouchers sold are administrative activities that are immaterial in the context of the contract with the merchant. Prior to its adoption of Topic 606, the Company deferred the revenue from hotel reservation offerings until the customer's stay commenced. Following its adoption of Topic 606, revenue from hotel reservation offerings is recognized at the time the reservation is made, net of an allowance for estimated cancellations.
The Company also earns commissions when customers make purchases with retailers using digital coupons accessed through its websites and mobile applications and from voucherless merchant offerings in which customers earn cash back on their credit card statements when they transact with third-party merchants. The Company recognizes those commissions as revenue in the period in which the underlying transactions between the customer and the third-party merchant are completed.
Variable Consideration for Unredeemed Vouchers
For merchant agreements with redemption payment terms, the merchant is not paid its share of the sale price for a voucher sold through one of the Company's online marketplaces until the customer redeems the related voucher. If the customer does not redeem a voucher with such merchant payment terms, the Company retains all of the gross billings for that voucher, rather than retaining only its net commission. Prior to its adoption of Topic 606, the Company recognized that variable consideration from unredeemed vouchers and derecognized the related accrued merchant payables when its legal obligation to the merchant expired, which the Company believes is shortly after the voucher expiration date in most jurisdictions. Following its adoption of Topic 606, the Company estimates the variable consideration from vouchers that will not ultimately be redeemed and recognizes that amount as revenue at the time of sale, rather than when the Company's legal obligation expires. The Company estimates variable consideration from unredeemed vouchers using its historical voucher redemption experience. If actual redemptions differ from the

Company's estimates, the effects could be material to the condensed consolidated financial statements.
Refunds
Prior to the adoption of Topic 606, refunds were recorded as a reduction of revenue, except for refunds on service revenue transactions for which the merchant's share was not recoverable, which were presented as a cost of revenue. Following the adoption of Topic 606, all refunds are recorded as a reduction of revenue. The liability for estimated refunds is included within Accrued expenses and other current liabilities on the consolidated balance sheets.
The Company estimates its refund reserve using historical refund experience by deal category. The Company assesses the trends that could affect its estimates on an ongoing basis and makes adjustments to the refund reserve calculations if it appears that changes in circumstances, including changes to the Company's refund policies or general economic conditions, may cause future refunds to differ from its initial estimates. If actual refunds differ from the Company's estimates, the effects could be material to the condensed consolidated financial statements.
Discounts, Customer Credits and Other Consideration Payable to Customers
The Company provides discount offers to encourage purchases of goods and services through its online marketplaces. The Company records discounts as a reduction of revenue.
Additionally, the Company issues credits to customers that can be applied to future purchases through its online marketplaces. Credits are primarily issued as consideration for refunds. To a lesser extent, credits are issued for customer relationship purposes. Credits issued to satisfy refund requests are applied as a reduction to the refunds reserve. Prior to the adoption of Topic 606, customer credits issued for relationship purposes were classified in the condensed consolidated statement of operations as a marketing expense. Following the adoption of Topic 606, customer credits issued for relationship purposes are classified as a reduction of revenue.
Prior to its adoption of Topic 606, the Company recognized breakage income for unused customer credits when they expired or were forfeited. Following its adoption of Topic 606, breakage income from customer credits that are not expected to be used is estimated and recognized as revenue in proportion to the pattern of redemption for customer credits that are used.
Sales and Related Taxes
Sales, use, value-added and related taxes that are imposed on specific revenue-generating transactions are presented on a net basis and excluded from revenue.
Costs of Obtaining Contracts
Prior to its adoption of Topic 606, the Company expensed the incremental costs to obtain contracts with third-party merchants, such as sales commissions, as incurred. Following its adoption of Topic 606, those costs are deferred and recognized over the expected period of the merchant arrangement, generally from 12 to 18 months. As of March 31, 2018, the Company had $3.9 million and $12.5 million of deferred contract acquisition costs recorded within Prepaid and other current assets and Other non-current assets, respectively. For the three months ended March 31, 2018, the Company amortized $6.8 million of deferred contract acquisition costs and did not recognize any impairment losses in relation to the deferred costs. Those costs are classified within Selling, general and administrative expenses in the condensed consolidated statements of operations.
Cost of Revenue
Cost of revenue is comprised of direct and certain indirect costs incurred to generate revenue. Costs incurred to generate revenue, which include credit card processing fees, editorial costs, compensation expense for technology support personnel who are responsible for maintaining the infrastructure of the Company's websites, amortization of internal-use software relating to customer-facing applications, web hosting and other processing fees are attributed to the cost of service and product revenue in proportion to gross billings during the period. For product revenue transactions, cost of revenue also includes the cost of inventory, shipping and fulfillment costs and inventory markdowns. Fulfillment costs are comprised of third-party logistics provider costs, as well as rent, depreciation, personnel costs and other costs of operating the Company's fulfillment center. Prior to adoption of Topic 606, cost of revenue on service revenue transactions also included refunds for which the merchant's share was not recoverable.
Financial Instruments
Prior to the adoption of the guidance in ASU 2016-01, investments in nonmarketable equity shares with no redemption provisions that are not common stock or in-substance common stock or for which the Company does not have the ability to exercise significant influence were accounted for using the cost method of accounting and are classified within Investments on the consolidated balance sheets. Under the cost method of accounting, investments

were carried at cost and adjusted only for other-than-temporary declines in fair value, certain distributions and additional investments. Subsequent to the adoption of the guidance in ASU 2016-01, the Company applies a measurement alternative for equity investments without readily determinable fair values that permits entities to elect to measure the investments at cost adjusted for observable price changes and impairments, with changes in the measurement recognized through net income.

3. DISCONTINUED OPERATIONS AND OTHER BUSINESS DISPOSITIONS

In October 2016, the Company completed a strategic review of its international markets in connection with its efforts to optimize its global footprint and focus on the markets that it believes have the greatest potential to benefit the Company's long-term financial performance. Based on that review, the Company decided to focus its business on 15 core countries and to pursue strategic alternatives for its operations in the remaining 11 countries, which were primarily based in Asia and Latin America. The dispositions of the Company's operations in those 11 countries were completed between November 2016 and March 2017.

A business disposition that represents a strategic shift and has (or will have) a major effect on an entity's operations and financial results is reported as a discontinued operation. The Company determined that the decision reached by its management and Board of Directors to exit those 11 non-core countries, which comprised a substantial majority of its operations outside of North America and EMEA, represented a strategic shift in its business. Additionally, based on its review of quantitative and qualitative factors relevant to the dispositions, the Company determined that the disposition of the businesses in those countries would have a major effect on its operations and financial results. As such, the results of operations and cash flows for its operations in those countries, including the gains and losses on the dispositions and related income tax effects, are presented as discontinued operations in the accompanying condensed consolidated financial statements for the three months ended March 31, 2018 and 2017.

Dispositions Completed in 2017

In connection with its strategic initiative to exit non-core countries as discussed above, the Company sold an 83% controlling stake in its subsidiary in Israel and sold its subsidiaries in Argentina, Chile, Colombia, Peru, Mexico, Brazil, Singapore and Hong Kong during the three months ended March 31, 2017. The Company recognized a net pretax loss on those dispositions of $1.3 million, which consisted of the following (in thousands):

	Three Months Ended March 31, 2017
Net consideration received:	
Fair value of minority investments retained or acquired	$ 2,021
Cash proceeds received	3,462
Cash proceeds receivable	2,000
Less: transaction costs	1,394
Total net consideration received	6,089
Cumulative translation gain reclassified to earnings	14,718
Less: Net book value upon closing of the transactions	14,596
Less: Indemnification liabilities [1]	5,365
Less: Unfavorable contract liability for transition services	