

Angie's List, Inc.  
Form 10-Q  
October 24, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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

**For the quarterly period ended September 30, 2013**

**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 001-35339**

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**ANGIE'S LIST, INC.**

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

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<b>Delaware</b> <b>(State or other jurisdiction of</b>	<b>27-2440197</b> <b>(I.R.S. Employer</b>
<b>incorporation or organization)</b>	<b>Identification Number)</b>
<b>1030 E. Washington Street</b>	<b>46202</b>
<b>Indianapolis, IN</b> <b>(Address of principal executive offices) (Zip Code)</b>	

**(888) 888-5478**

**(Registrant's telephone number, including area code)**

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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 to 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 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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 of registrant's common stock outstanding as of October 23, 2013 was: 58,422,542

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**ITEM 1. FINANCIAL STATEMENTS****Angie's List, Inc.****Consolidated Balance Sheets***(in thousands, except share data)*

	<b>September 30,</b>	<b>December 31,</b>
	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Cash and cash equivalents	\$ 41,609	\$42,638
Restricted cash	50	50
Short-term investments	20,972	10,460
Accounts receivable, net of allowance for doubtful accounts of \$1,050 and \$922 at September 30, 2013 and December 31, 2012	10,636	7,787
Prepaid expenses and other current assets	15,000	19,810
Total current assets	88,267	80,745
Property and equipment, net	16,003	12,079
Goodwill	1,145	415
Amortizable intangible assets, net	3,864	2,356
Deferred financing fees, net	456	634
Total assets	\$ 109,735	\$96,229
<b>Liabilities and stockholders' equity (deficit)</b>		
Accounts payable	\$ 3,814	\$6,489
Accrued liabilities	35,481	14,058
Deferred membership revenue	37,563	27,627
Deferred advertising revenue	35,564	23,160
Total current liabilities	112,422	71,334
Long-term debt, including accrued interest	14,906	14,869
Deferred membership revenue, noncurrent	4,888	4,330
Deferred advertising revenue, noncurrent	387	214
Deferred income taxes	163	163
Total liabilities	132,766	90,910
<i>Commitments and contingencies (Note 9)</i>		
Stockholders' equity (deficit):		
Preferred stock, \$0.001 par value: 10,000,000 shares authorized, no shares issued or outstanding at September 30, 2013 and December 31, 2012	—	—
Common stock, \$0.001 par value: 300,000,000 shares authorized, 66,974,754 and 66,425,988 shares issued and 58,416,042 and 57,867,276 shares outstanding at September 30, 2013 and December 31, 2012, respectively	67	66

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Additional paid-in-capital	255,767	248,326
Treasury stock, at cost: 8,558,712 shares of common stock at September 30, 2013 and December 31, 2012	(23,719 )	(23,719 )
Accumulated deficit	(255,146 )	(219,354)
Total stockholders' equity (deficit)	(23,031 )	5,319
Total liabilities and stockholders' equity (deficit)	\$ 109,735	\$96,229

*See accompanying notes.*

**Angie's List, Inc.****Consolidated Statements of Operations***(in thousands, except share and per share data)*

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
<b>Revenue</b>				
Membership	\$ 17,050	\$ 12,769	\$ 47,598	\$ 34,036
Service provider	48,450	29,253	129,288	75,584
Total revenue	65,500	42,022	176,886	109,620
<b>Operating expenses</b>				
Operations and support	11,016	7,140	29,418	19,631
Selling	23,960	16,240	65,582	42,974
Marketing	28,189	26,088	75,870	71,316
Technology	6,942	4,905	19,349	12,223
General and administrative	8,421	5,669	21,019	17,420
Operating loss	(13,028 )	(18,020 )	(34,352 )	(53,944 )
Interest expense, net	468	467	1,395	1,380
Loss before income taxes	(13,496 )	(18,487 )	(35,747 )	(55,324 )
Income tax expense	15	—	45	—
Net loss	\$(13,511 )	\$(18,487 )	\$(35,792 )	\$(55,324 )
Net loss per common share—basic and diluted	\$(0.23 )	\$(0.32 )	\$(0.62 )	\$(0.96 )
Weighted average number of common shares outstanding—basic and diluted	58,389,311	57,768,777	58,164,232	57,369,674

*See accompanying notes.*

**Angie's List, Inc.****Consolidated Statements of Cash Flows***(in thousands)*

	<b>Nine Months Ended September 30, 2013      2012 (Unaudited)</b>	
<b>Operating activities</b>		
Net loss	\$(35,792)	\$(55,324)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,874	1,960
Amortization of debt discount, deferred financing fees and bond premiums	420	209
Noncash compensation expense	2,666	2,213
Changes in certain assets:		
Accounts receivable	(2,849 )	(3,353 )
Prepaid expenses and other current assets	4,810	(7,994 )
Changes in certain liabilities:		
Accounts payable	(3,175 )	4,152
Accrued liabilities	21,423	12,601
Deferred advertising revenue	12,577	6,540
Deferred membership revenue	10,494	11,199
Net cash provided by (used in) operating activities	13,448	(27,797)
<b>Investing activities</b>		
Restricted cash	—	250
Purchase of short-term investments	(27,572)	—
Sale of short-term investments	16,855	—
Acquisition of business assets	(2,150 )	—
Property and equipment	(5,685 )	(2,583 )
Data acquisition costs	(701 )	(1,968 )
Net cash used in investing activities	(19,253)	(4,301 )
<b>Financing activities</b>		
Sale of common stock, net of costs	—	8,627
Proceeds from exercise of stock options	4,776	361
Net cash provided by financing activities	4,776	8,988
Net decrease in cash and cash equivalents	(1,029 )	(23,110)
Cash and cash equivalents, beginning of period	42,638	88,607
Cash and cash equivalents, end of period	\$41,609	\$65,497

*See accompanying notes.*





**Angie's List, Inc.**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

*(in thousands, except share and per share data)*

**1. Summary of Significant Accounting Policies**

**Nature of Operations and Reorganization**

Angie's List, Inc. (collectively with its wholly owned subsidiaries, the "Company") operates a consumer-driven service for its members to research, hire, rate and review local professionals for critical needs, such as home, health care and automotive services. Ratings and reviews, which are available only to the Company's members, help its members to find the best provider for their local service needs. Membership subscriptions are sold on a monthly, annual and multi-year basis. The consumer rating network "Angie's List" is maintained and updated based on member feedback. The Company also sells advertising in its monthly publication, on its website, and through its call center to service providers that meet certain rating criteria. The Company's services are provided in metropolitan areas located across the continental United States.

The accompanying unaudited Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and footnotes necessary for fair presentation of financial position, results of operations and cash flows in conformity with U.S. generally accepted accounting principles. Operating results from interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. The Company is subject to seasonal patterns that generally affect its business. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates, but management does not believe such differences will materially affect Angie's List, Inc.'s financial position or results of operations. The Consolidated Financial Statements reflect all adjustments considered, in the opinion of management, necessary to fairly present the results for the periods. Such adjustments are of a normal recurring nature.

For further information, including the Company's significant accounting policies, refer to the audited Consolidated Financial Statements and the notes thereto for the year ended December 31, 2012. As used herein, the terms "Angie's List", "Company", "we", "our" and "us" mean Angie's List, Inc. and its consolidated subsidiaries.

Operating segments are defined as components of an enterprise engaging in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company manages its business on the basis of one operating segment.

### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

### **Revenue Recognition and Deferred Revenue**

The Company recognizes revenue when all of the following conditions are met: there is persuasive evidence of an arrangement; the service has been provided to the customer; the collection of the fees is reasonably assured; and the amount of fees to be paid by the customer is fixed or determinable.

***Membership Revenue***

Revenue from the sale of membership subscriptions is recognized ratably over the term of the associated subscription.

At the time a member joins, the Company may receive a one-time nonrefundable enrollment fee. Enrollment fees are deferred and recognized on a straight-line basis over an estimated average membership life of 76 months for annual or multi-year members and 15 months for monthly members, which is based on historical membership experience. The Company reviews the estimated average membership life on an annual basis, or more frequently if circumstances change. Changes in member behavior, performance, competition, and economic conditions may cause attrition levels to change, which could impact the estimated average membership life.

***Service Provider Revenue***

Revenue from the sale of advertising in the Company's publication is recognized in the month in which the Company's monthly publication is published and distributed. Revenue from the sale of website and call center advertising is recognized ratably over the time period the advertisements run. Revenue from e-commerce vouchers is recognized on a net basis when the voucher has been delivered to the purchaser. The Company's e-commerce revenue was \$6,472 and \$3,806 for the three months ended September 30, 2013 and 2012, respectively, and \$16,090 and \$11,008 for the nine months ended September 30, 2013 and 2012, respectively.

**2. Net Loss Per Common Share**

Basic and diluted net loss per common share is computed by dividing consolidated net loss by the weighted average number of common shares outstanding for the period.

The following potential dilutive equity securities are not included in the diluted net loss per common share calculation because they would have had an antidilutive effect:

	<b>September 30, 2013</b>	<b>September 30, 2012</b>
Stock options	2,980,233	2,794,562
Warrants	—	88,240

### 3. Fair Value Measurements

Whenever possible, quoted prices in active markets are used to determine the fair value of our financial instruments. Our financial instruments are not held for trading or other speculative purposes. The estimated fair value of financial instruments has been determined by using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

#### *Fair Value Hierarchy*

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 *Fair Value Measurement Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards* defined and established a framework for measuring fair value and expands disclosures about fair value measurements for financial assets and liabilities that are adjusted to fair value on a recurring basis and/or financial assets and liabilities that are measured at fair value on a nonrecurring basis, which have been adjusted to fair value during the period. In accordance with ASC 820, we have categorized our financial assets and liabilities that are adjusted to fair value, based on the priority of the inputs to the valuation technique, following the three-level fair value hierarchy prescribed by ASC 820, as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

*Valuation Techniques*

The Company's cash equivalents are classified within Level 1 on the basis of valuations using quoted market prices. Because many fixed income securities do not trade daily, fair values are often derived using recent trades of securities with similar features and characteristics. When recent trades are not available, pricing models are used to determine these prices. These models calculate fair values by discounting future cash flows at estimated market interest rates. Such market rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities, based on the credit quality, industry and structure of the asset. Typical inputs and assumptions to pricing models include, but are not limited to, a combination of benchmark yields, reported trades, issuer spreads, liquidity, benchmark securities, bids, offers, reference data, and industry and economic events. The Company's fixed income corporate bond investments and certificates of deposit with fixed maturities are valued using recent trades or pricing models and are therefore classified in Level 2.

There were no movements between fair value measurement levels of the Company's cash equivalents and short-term investments during 2013. There were no material unrealized gains or losses as of September 30, 2013 or December 31, 2012. The following tables summarize the financial instruments of the company at fair value based on the fair value hierarchy for each class of instrument as of September 30, 2013 and December 31, 2012:

	Carrying Value at September 30, 2013	Fair Value Measurement at September 30, 2013 Using Quoted Prices in			
		Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Significant Unobservable Inputs (Level 3)
Cash equivalents:					
Money market funds	\$ 696	\$ 696	\$ —	\$ —	\$ —
Investments:					
Certificates of deposit	10,430	—	10,416	—	—
Corporate bonds	10,542	—	10,538	—	—
Total assets	\$ 21,668	\$ 696	\$ 20,954	\$ —	\$ —

**Fair Value Measurement at  
December 31, 2012 Using  
Quoted  
Prices**

	<b>Carrying Value at December 31, 2012</b>	<b>in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Cash equivalents:				
Money market funds	\$ 1,183	\$ 1,183	\$ —	\$ —
Investments:				
Certificates of deposit	2,640	—	2,639	—
Corporate bonds	7,820	—	7,816	—
Total assets	\$ 11,643	\$ 1,183	\$ 10,455	\$ —

The carrying amount of the term loan approximates its fair value, using level two inputs, because this borrowing bears interest at a variable (market) rate at September 30, 2013 and December 31, 2012.

**4. Prepaid and other current assets**

Prepaid expenses and other current assets were comprised of the following:

	<b>September 30,</b>	<b>December 31,</b>
	<b>2013</b>	<b>2012</b>
Prepaid and deferred commissions	\$ 10,495	\$ 17,215
Other	4,505	2,595
Total prepaid expenses and other current assets	\$ 15,000	\$ 19,810

**5. Property and Equipment**

Property and equipment was comprised of the following:

	<b>September 30,</b>	<b>December 31,</b>
	<b>2013</b>	<b>2012</b>
Furniture and equipment	\$ 7,404	\$ 5,929
Land	1,464	1,401
Buildings and improvements	8,234	6,417
Software	3,568	1,949
	20,670	15,696
Less accumulated depreciation	(4,667 )	(3,617 )
	\$ 16,003	\$ 12,079

**6. Accrued liabilities**

Accrued liabilities were comprised of the following:

	<b>September 30,</b>	<b>December 31,</b>
	<b>2013</b>	<b>2012</b>
Accrued sales commissions	\$ 2,474	\$ 4,342
Sales and use tax	2,841	2,130

Accrued compensation	5,960	2,246
Uninvoiced accounts payable	17,985	2,372
Other	6,221	2,968
Total accrued liabilities	\$ 35,481	\$ 14,058

## 7. Debt and Credit Arrangements

On August 31, 2011, the Company entered into a loan and security agreement that provides for a \$15,000 term loan and a \$15,000 revolving credit facility. As of September 30, 2013 and December 31, 2012, the Company had \$15,000 in outstanding borrowings under the term loan and available credit of \$15,000 under the revolving credit facility.

The loan and security agreement contains various restrictive covenants, including restrictions on the Company's ability to dispose of assets, make acquisitions or investments, incur debt or liens, make distributions to stockholders or enter into certain types of related party transactions. The Company is also required to comply with certain financial covenants, including a minimum asset coverage ratio, and non-financial covenants. Upon an event of default, which includes a material adverse change, the lenders may accelerate amounts outstanding, terminate the agreement and foreclose on all collateral. The Company was in compliance with all financial and non-financial covenants at September 30, 2013 and December 31, 2012.



## 8. Acquisition

On August 2, 2013 Angie's List acquired substantially all of the assets of SmartHabitat, Inc. (“BrightNest”) for a purchase price of \$2,650. The purchase price consists of \$2,150 in cash paid at closing and an additional \$500 which is payable on the one-year anniversary of the closing, subject to certain performance criteria of BrightNest employees hired by the Company on the acquisition date. The acquisition of the BrightNest assets adds a user-friendly front end and personalized member experience with expanded content offerings, and enhanced technologies. Revenues and expenses related to BrightNest, which were not material for the period ended September 30, 2013, are included in the consolidated results of operations from the date of acquisition.

The following table summarizes the purchase price allocation based on the preliminary fair values of the assets acquired at the date of acquisition:

	<b>Fair Value Allocation</b>	<b>Weighted Average Amortization Period</b>  (in years)
Acquired intangible assets:		
Member list	\$ 1,670	6.0
Content	140	3.0
Core technology	110	3.0
	1,920	5.6
Goodwill	730	
Total assets acquired	\$ 2,650	

Goodwill recognized from the acquisition primarily relates to the expected contributions of BrightNest to the overall Company strategy in addition to synergies and acquired workforce, which are not separable from goodwill.

## 9. Commitments and Contingencies

### Legal Matters

From time to time, the Company may become party to litigation incident to the ordinary course of business. The Company assesses the likelihood of any adverse judgments or outcomes with respect to these matters and determines loss contingency assessments on a gross basis after assessing the probability of incurrence of a loss and whether a loss is reasonably estimable. In addition, the Company considers other relevant factors that could impact its ability to reasonably estimate a loss. A determination of the amount of reserves required, if any, for these contingencies is made after analyzing each matter. The Company's reserves may change in the future due to new developments or changes in strategy in handling these matters. Although the results of litigation and claims cannot be predicted with certainty, the Company currently believes that the final outcome of these matters will not have a material adverse effect on its business, consolidated financial position, results of operations, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors.

A lawsuit seeking class action status, *Fritzinger v. Angie's List*, was filed against the Company on August 14, 2012 in the U.S. District Court for the Southern District of Indiana (the "Court"). After the Court granted the Company's partial Motion to Dismiss plaintiff's deception claims, the lawsuit currently alleges claims for breach of contract, and unjust enrichment. Plaintiff filed her Brief in Support of her Amended Motion for Class Certification, which requests certification of two classes of current and former Angie's List members, dating from January 1, 2009 through present, who meet either (1) members whose membership were renewed at a fee that exceeded the lowest prevailing new-member fee for the corresponding membership product; and (2) members: (a) who were in a market that has been converted to "paid health" status, (b) whose memberships predated that market's conversion to "paid health" status, and (c) whose memberships were automatically renewed in an "Angie's List Bundle" membership upon their first renewal following their market's conversion to "paid health" status. The plaintiff seeks compensatory damages and an award of treble damages, attorneys' fees and costs. The Company believes this suit is without merit and continues to defend itself vigorously in this matter.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the notes thereto included elsewhere in this report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this report, particularly in the "Risk Factors" section.*

### **Overview**

We operate a consumer-driven service for our members to research, hire, rate and review local professionals for critical needs, such as home, health care and automotive services. Our ratings and reviews, which are available only to our members, help our members find the best provider for their local service needs. We had approximately 2.4 million paid memberships at September 30, 2013. We allow local service providers who are highly rated by our members to advertise discounts and other promotions to our members.

We generate revenue from both our members and our service providers. We derive membership revenue from subscription fees and, in certain cases, non-refundable initiation fees for monthly, annual and multi-year memberships. These fees typically are charged in advance and recognized ratably over the subscription period and the expected life of the membership, respectively. As of September 30, 2013, approximately 93% of our total membership base had purchased annual or multi-year memberships. These subscription fees represent a significant source of working capital and provide a relatively predictable revenue stream.

We derive service provider revenue principally from term-based sales of advertising to local service providers. Our members grade local service providers on an "A" to "F" scale, and we invite local service providers with an average grade of "B" or better and at least two reviews submitted in the last three years to advertise to our members through any or all of our website, email promotions, monthly magazine and call center. Service provider contracts can be prepaid or invoiced monthly at the option of the service provider and carry an early termination penalty. We recognize service provider revenue for these contracts ratably over the period in which an advertising campaign is run. We are expanding our service provider sales force to continue to drive increased service provider revenue. Our high service provider renewal rate as a percentage of initial contract value renewed, has provided us with a relatively predictable revenue stream.

In addition to traditional advertising on our website and publications, our e-commerce solutions offer our members the opportunity to purchase services through us from service providers that are highly rated on our website. These offerings are available through both email promotions and through postings on our website. When the member purchases a service, the transaction is processed through Angie's List. The member then can work directly with the service provider to schedule the service. These e-commerce offerings provide our members a discount and an easier way to fulfill their service needs.

To establish a new market, we begin by offering free memberships and actively soliciting members' reviews of local service providers. As the number of members and the number of reviews of service providers grow, we begin charging membership fees and offering advertising opportunities to eligible local service providers. Historically, we have begun to convert most markets to paid membership status within 24 months after launch.

Increasing new paid memberships is our key growth strategy. Increased penetration in a market results in more member reviews of local service providers, which increases the value of our service to consumers and drives further membership growth in that market. Increased penetration in a market also drives increased advertising sales to service providers and supports higher advertising rates as the pool of members actively seeking to hire service providers grows. However, our ability to increase advertising rates tends to lag increased penetration of our markets due to our inability to increase rates under existing service provider contracts prior to renewal. Our primary strategy for new member acquisition is national advertising. Our marketing expense increases in the second and third quarters of the year, typically peaking in the third quarter, as we increase our investment in advertising to attract consumers during the periods when we have found they are most actively seeking Angie's List services.

We have completed our transition to the new compensation structure for our sales force responsible for new advertising originations whereby we pay commissions to our employees as cash is collected from our service providers rather than upfront at booking, as we had done historically. We have seen a reduction in our prepaid expenses and therefore we have experienced a positive impact on our operating cash flows, as it allowed us to grow newly originated service provider revenue on a primarily self-funded basis. In 2013, our prepaid expenses related to commissions decreased while service provider revenue increased, which contributed to our ability to generate positive operating cash flows of \$13.4 million for the nine months ended September 30, 2013 compared to negative operating cash flows of \$27.8 million in the prior year period.

On August 2, 2013 we acquired substantially all of the assets of SmartHabitat, Inc. ("BrightNest") for a purchase price of \$2.7 million. The purchase price consists of \$2.2 million in cash paid at closing and an additional \$0.5 million which is payable on the one-year anniversary of the closing, subject to certain performance criteria of BrightNest employees hired by us on the acquisition date. The acquisition of the BrightNest assets adds a user-friendly front end and personalized member experience with expanded content offerings, and enhanced technologies. Revenues and expenses related to BrightNest, which were not material for the period ended September 30, 2013, are included in the consolidated results of operations from the date of acquisition.



## Market Cohort Analysis

To analyze our progress in executing our expansion plan, we compile certain financial and operating data regarding markets we have entered grouped by the years in which the markets transitioned to paid membership status. The table below summarizes this data for the twelve month period ended September 30, 2013 by the following cohorts. The pre-2003 cohort includes our ten most established markets, where we initially built out our business model. The markets in this cohort include several mid-sized urban markets in the Midwest as well as Chicago and Boston. The 2003-2007 cohort includes the first major subset of markets, including many of our largest potential markets, which we targeted in our national expansion strategy. The markets in this cohort have begun to achieve penetration rates that allow us to transition beyond introductory membership and advertising rates. The 2008-2010 and post-2010 cohorts include markets that have most recently converted to paid status and that still have predominantly introductory membership and advertising rates. The markets in these cohorts generally are smaller markets that we entered to fill out our national presence.

Cohort	# of Markets	Avg. Revenue/Market(1)	Membership Revenue/Paid Membership(2)	Service	Avg.	Total Paid Memberships(5)	Estimated Penetration Rate(6)	Annual Membership Growth	
				Provider Revenue/Paid Revenue(3)	Marketing Expense/Market(4)			Rate(7)	Rate(7)
Pre-2003	10	\$5,933,585	\$ 39.05	\$ 110.62	\$ 1,285,741	454,016	10.7 %	34 %	%
2003-2007	35	3,965,746	34.20	92.42	1,352,104	1,293,550	8.3 %	44 %	%
2008-2010	103	220,786	16.28	32.40	187,168	550,209	8.6 %	43 %	%
Post 2010	96	20,885	12.07	22.49	55,460	81,092	4.6 %	*	
Total	244					2,378,867			

\* Not meaningful

(1) Average revenue per market is calculated by dividing the revenue recognized for the markets in a given cohort by the number of markets in the cohort at period end.

(2) Membership revenue per paid membership is calculated as our membership revenue in the cohort divided by the average number of paid memberships in the cohort. We calculate this average per market to facilitate comparisons among cohorts, but it is not intended to represent typical characteristics of actual markets within the cohort.

(3) Service provider revenue per paid membership is calculated as service provider revenue in the cohort divided by the average number of paid memberships in the cohort.

(4) Average marketing expense per market is calculated first by allocating marketing expense to each cohort based on the percentage of our total target demographic for all markets in such cohort, as determined by third-party data, and then dividing the allocated cohort marketing expense by the number of markets in the cohort at period end. We calculate this average per market to facilitate comparisons among cohorts, but it is not intended to represent typical characteristics of actual markets within the cohort. According to a September 2013 demographic study by Merkle Inc. that we commissioned, there were approximately 31 million households in the United States in our target demographic, which consists of homeowners aged 35 to 64 with an annual household income of at least \$75,000.

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Approximately 28 million of these households were in our markets. The average number of households per market in our demographic target was 425,000, 445,000, 60,000 and 20,000 for the pre-2003, 2003-2007, 2008-2010 and post-2010 cohorts, respectively.

- (5) Includes total paid memberships as of September 30, 2013. Total paid memberships in each cohort includes a de minimis number of complimentary memberships in our paid markets for the period presented. All revenue and paid memberships relating to locations that were not identified as part of a specific market are included in the 2008-2010 cohort.
- (6) Estimated penetration rate is calculated by dividing the number of paid memberships in a given cohort as of September 30, 2013 by the number of households meeting our target demographic criteria in such cohort.
- (7) Annual membership growth rate is the rate of increase in the total number of paid memberships in the cohort between September 30, 2013 and September 30, 2012.

Our average revenue per market, membership revenue per paid membership, and service provider revenue per paid membership generally increase with the maturity and corresponding increased penetration of our markets. However, we expect total revenue per paid membership to fluctuate from period to period and in the period presented as we recorded declining total revenue per paid membership overall. This decline reflects rapid membership growth in less penetrated markets where the average membership and service provider revenue per paid membership is lower than in more penetrated markets. In addition, the decline reflects a lag in our ability to leverage increased penetration in a market into increased advertising rates as our average advertising contract term is typically more than one year and we are only able to increase rates for a given participating service provider upon contract renewal.

We also have adopted a dynamic pricing model in 78 of our mature markets to offer members the opportunity to purchase only those segments of Angie's List that are most relevant to them, which includes the original Angie's List, which covers 396 categories, including home, lawn, car and pets, Angie's List Health & Wellness or Angie's List Classic Cars. These segments continue to be offered in all other markets as a single bundle. We anticipate unbundling our offerings in more of our markets as market penetration increases and the number and categories of local service providers reviewed by members in such markets grow. We believe this pricing model will enable us to offer a better value proposition to our members and preserve cross-selling opportunities as members' needs evolve. Although we expect that this strategy may result in lower average membership fees per paid membership overall, we believe the new members generated by this pricing model should ultimately produce increased service provider revenue per paid membership. Additionally, while membership revenue per paid membership has declined sequentially in recent periods in our more mature cohorts in part as a result of this dynamic pricing model, service provider revenue per paid membership and total revenue per paid membership have generally continued to increase across all cohorts. In our pre-2003 cohort, service provider revenue per paid membership typically have declined slightly in the second and third quarter over the preceding quarter, due to seasonal increases in the number of paid memberships.

As a market matures, our penetration rate typically increases. Historically, while the absolute number of paid members may grow faster in large markets, our small and medium markets have often achieved greater penetration over a shorter time period than our larger markets. We believe that a principal reason for our lower penetration rates in large markets is the manner in which we market Angie's List to our target demographic in such markets. We have chosen to spend 100% of our marketing dollars on national advertising. We believe that this advertising strategy provides us the most cost effective and efficient manner of acquiring new paid memberships. However, advertising nationally means we deliver the same volume of advertising regardless of the size of the market. Since each market differs in terms of the number of advertising outlets available, the impact of our spending on national advertising varies across markets. In our experience, smaller markets typically have fewer advertising outlets than larger markets. We believe the same volume of advertising in a smaller market is more effective in building brand awareness and generating new memberships than in larger markets. We expect to continue to see lower relative penetration rates in our larger markets for these reasons. Because several of these larger markets are in the 2003-2007 cohort, over time our penetration rate in this cohort may lag other cohorts.

## **Key Operating Metrics**



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In addition to the line items in our financial statements, we regularly review a number of other operating metrics related to our membership and service provider bases to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe information on these metrics is useful for investors and analysts to understand the underlying trends in our business. The following table summarizes our key operating metrics, which are unaudited, for the three and nine months ended September 30, 2013 and 2012:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Total paid memberships (end of period)	2,378,867	1,656,768	2,378,867	1,656,768
Gross paid memberships added (in period)	371,318	341,522	993,556	862,014
Marketing cost per paid membership acquisition (in period)	\$76	\$76	\$76	\$83
First-year membership renewal rate (in period)	75	% 76	% 75	% 76
Average membership renewal rate (in period)	78	% 78	% 78	% 78
Participating service providers (end of period)	44,876	33,209	44,876	33,209
Total service provider contract value (end of period, in thousands)	\$181,975	\$119,091	\$181,975	\$119,091

*Total paid memberships.* Total paid memberships reflects the number of paid memberships at the end of each period presented. Total paid memberships also includes a de minimis number of complimentary memberships in our paid markets for the periods presented. We generally expect that there will be one membership per household and, as such, each membership may actually represent multiple individual consumers.

*Gross paid memberships added.* Gross paid memberships added reflects the total number of new paid memberships added in a reporting period. Gross paid memberships added increased in each period presented, which we believe has been driven by our increasing investment in national advertising and, to a lesser extent, by “word of mouth” referrals from our existing members.

*Marketing cost per paid membership acquisition.* We calculate marketing cost per paid membership acquisition in a reporting period as marketing expense divided by gross paid memberships added in that period. Because we advertise in national media, some of our marketing expense also increases the number of unpaid memberships. On a comparative basis, marketing cost per paid membership acquisition can reflect our success in generating “word of mouth” referrals and experimentation and adjustments to our marketing expense to focus on more effective advertising outlets for membership acquisition. We typically have higher marketing expense and marketing cost per paid membership acquisition in the second and third quarters of the year in order to attract consumers during the periods when we have found they are most actively seeking Angie’s List services. As such, marketing cost per paid membership also tends to be higher in these periods, particularly in the second and third quarters as we ramp up spending to build brand awareness. Our marketing expense and marketing cost per paid membership acquisition is normally reduced in the fourth quarter, reflecting reduced consumer activity in the service sector and higher advertising rates generally due to holiday promotional activity.

*Membership renewal rates.* First-year membership renewal rate reflects the percentage of paid memberships expiring in the reporting period after the first year of membership that are renewed. Average membership renewal rate reflects the percentage of all paid memberships expiring in the reporting period that are renewed. Renewal rates do not include monthly memberships, which comprised approximately 7% of our total membership base as of September 30, 2013. Given the correlation between increased penetration and higher total revenue per paid membership, we view first-year membership renewal rate and average membership renewal rate as key indicators of expected operating results in future periods.

*Participating service providers.* We include in participating service providers the total number of service providers under contract for advertising at the end of the period.

*Total service provider contract value.* We calculate service provider contract value as the total contract value of active service provider contracts at the end of the period. Contract value is the total payment obligation of a service provider to us, including amounts already recognized in revenue, over the stated term of the contract.

In addition, we track contract value backlog as a key metric. Contract value backlog consists of the portion of service provider contract value at the stated date which has not yet been recognized as revenue. At September 30, 2013 and 2012 our contract value backlog was \$114.3 million and \$74.9 million, respectively.

## Results of Operations

The following tables set forth our results of operations for the periods presented in absolute dollars and as a percentage of our revenue for those periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2013</b>	<b>2012</b>	<b>September 30, 2013</b>	<b>2012</b>
	<b>(dollars in thousands)</b>		<b>(dollars in thousands)</b>	
<b>Revenue</b>				
Membership	\$17,050	\$12,769	\$47,598	\$34,036
Service provider	48,450	29,253	129,288	75,584
Total revenue	65,500	42,022	176,886	109,620
<b>Operating expenses</b>				
Operations and support(1)	11,016	7,140	29,418	19,631
Selling(1)	23,960	16,240	65,582	42,974
Marketing	28,189	26,088	75,870	71,316
Technology(1)	6,942	4,905	19,349	12,223
General and administrative(1)	8,421	5,669	21,019	17,420
<b>Operating loss</b>	<b>(13,028)</b>	<b>(18,020)</b>	<b>(34,352 )</b>	<b>(53,944 )</b>
Interest expense, net	468	467	1,395	1,380
Net loss before income taxes	\$(13,496)	\$(18,487)	\$(35,747 )	\$(55,324 )
Income tax expense	15	—	45	—
<b>Net loss</b>	<b>\$(13,511)</b>	<b>\$(18,487)</b>	<b>\$(35,792 )</b>	<b>\$(55,324 )</b>

(1)Includes non-cash stock-based compensation as follows:

Operations and support	\$19	\$—	\$52	\$—
Selling	50	—	\$101	\$—
Technology	(418 )	225	\$(55 )	\$563
General and administrative	1,025	545	2,568	1,650
	\$676	\$770	\$2,666	\$2,213

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>
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	<b>September 30, 2013</b>		<b>September 30, 2012</b>	
<b>Revenue</b>				
Membership	26 %	30 %	27 %	31 %
Service provider	74	70	73	69
Total revenue	100 %	100 %	100 %	100 %
<b>Operating expenses</b>				
Operations and support	17	17	17	18
Selling	36	39	37	39
Marketing	43	62	43	65
Technology	11	12	11	11
General and administrative	13	13	12	16
<b>Operating loss</b>	(20 )	(43 )	(20 )	(49 )
Interest expense, net	1	1	1	1
Net loss before income taxes	(21 )	(44 )	(21 )	(50 )
Income tax expense	—	—	—	—
<b>Net loss</b>	(21 )%	(44 )%	(21 )%	(50 )%

**Comparison of the three months ended September 30, 2013 and 2012****Revenue**

	<b>Three Months Ended</b>			
	<b>September 30,</b>			
	<b>2013</b>	<b>2012</b>	<b>%</b>	
	<b>(dollars in thousands)</b>		<b>Change</b>	
Revenue				
Membership	\$17,050	\$12,769	34	%
Service provider	48,450	29,253	66	%
Total revenue	\$65,500	\$42,022	56	%
Percentage of revenue by type				
Membership	26	% 30		%
Service provider	74	% 70		%
Total revenue	100	% 100		%
Total paid memberships (end of period)	2,378,867	1,656,768	44	%
Gross paid memberships added (in period)	371,318	341,522	9	%
Participating service providers (end of period)	44,876	33,209	35	%

Total revenue increased \$23.5 million for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012.

Membership revenue increased \$4.3 million primarily due to a 44% increase in the total number of paid memberships, partially offset by a 9% decrease in membership revenue per paid membership in the three months ended September 30, 2013. The decrease in membership revenue per paid membership resulted from growth in paid memberships in less penetrated markets where average membership fees per paid membership are lower. This decline also reflected the effect of allowing members in our more penetrated markets to purchase only those segments of Angie's List that are most relevant to them at a lower membership rate than applicable for the full service. We offer only bundled memberships to members in less penetrated markets. The decrease in membership revenue per paid membership in the three months ended September 30, 2013 also resulted from an increase from 90% to 93% of total memberships constituting annual and multi-year memberships. Consumers pay more per month for a monthly membership than for an annual membership. Therefore, in periods in which our percentage of memberships shifts to more annual and multi-year memberships, our membership revenue per paid membership decreases.

Service provider revenue increased \$19.2 million to 74% of total revenue primarily as a result of a 35% increase in the number of local service providers participating in our advertising programs and a 10% increase in the average service provider contract value. Service provider revenue primarily consists of revenue from advertising contracts with service providers. E-commerce revenue of \$6.4 million and \$3.8 million is included in service provider revenue in the three months ended September 30, 2013 and 2012, respectively. Our e-commerce revenue is generated by our Angie's List Big Deal and Storefront offerings. We expect the revenue contribution from these offerings to fluctuate from period to period as the offerings evolve and due to seasonality.

**Operations and support**

	<b>Three Months Ended September 30,</b>			
	<b>2013</b>	<b>2012</b>	<b>% Change</b>	
	<b>(dollars in thousands)</b>			
Operations and support	\$11,016	\$7,140	54	%
Percentage of revenue	17	% 17	%	

Operations and support expense increased \$3.9 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. This increase was due in part to a \$1.8 million increase in call center costs as compared to the prior year period as we increased our headcount to meet the needs of our members and service providers. In addition, there was a \$1.4 million increase in publication costs as we increased the circulation of our *Angie's List Magazine* and an increase in credit card processing fees for increased member enrollment and service provider transactions. We expect operations and support expense to continue to increase in absolute dollars as we grow our membership and service provider bases.

Operations and support expense remained consistent as a percentage of revenue. We expect operations and support to remain relatively consistent as a percent of revenue in future periods.

**Selling**

	<b>Three Months Ended September 30,</b>			
	<b>2013</b>	<b>2012</b>	<b>% Change</b>	
	<b>(dollars in thousands)</b>			
Selling	\$23,960	\$16,240	48	%
Percentage of revenue	36	% 39	%	

Selling expense increased \$7.7 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Service provider revenue increased 66% over the same period in the prior year. We increased the number of our sales personnel originating new advertising contracts and generating e-commerce

offerings by 32% to 732 and the number of our sales personnel responsible for contract renewals by 49% to 186 from the end of the prior year period.

Selling expense as a percentage of revenue decreased for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012 primarily as a result of our transition to a new compensation structure for our sales force. As selling expense primarily consists of commissions, we generally expect it to fluctuate with service provider revenue and the composition of that revenue over time.

**Marketing**

	<b>Three Months Ended September 30,</b>		<b>% Change</b>	
	<b>2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
Marketing	\$28,189	\$26,088	8	%
Percentage of revenue	43	% 62	%	
Gross paid memberships added in the period	371,318	341,522	9	%
Marketing cost per paid membership acquisition	\$76	\$76		

Marketing expense increased \$2.1 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012, due to a planned increase in national advertising to acquire new members.

Marketing expense as a percentage of revenue decreased from the prior year period due to total revenue increasing at a greater rate than marketing expense increased in absolute dollars. Our marketing cost per paid membership acquisition remained consistent. Consistent with the seasonality that characterizes our business, our marketing expense and marketing cost per paid membership acquisition typically peak in the second or third quarters of the year.



**Technology**

	<b>Three Months Ended September 30,</b>		<b>% Change</b>	
	<b>2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
Technology	\$6,942	\$4,905	42	%
Percentage of revenue	11 %	12 %		
Non-cash stock-based compensation	\$(418 )	\$225		

Technology expense increased \$2.0 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in technology expense was primarily attributable to a \$1.0 million increase in personnel-related costs as well as costs incurred to continue to develop our technology platform and service our growing base of members and service providers. This increase is partially offset by a decrease in non-cash stock based compensation due to forfeitures in the current period. We expect technology expense to continue to increase in absolute dollars in future periods as we continue to develop our technology platform and service our growing base of members and service providers.

Technology expense as a percentage of revenue was consistent compared to the prior year period. We expect technology expense to continue to remain relatively consistent as a percentage of revenue.

**General and administrative**

	<b>Three Months Ended September 30,</b>		<b>% Change</b>	
	<b>2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
General and administrative	\$8,421	\$5,669	49	%
Percentage of revenue	13 %	13 %		
Non-cash stock-based compensation	\$1,025	\$545		

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General and administrative expense increased \$2.8 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. This increase is primarily the result of increases in personnel, professional and other consulting fees, product development, and general business costs to support the growth of the company. We expect general and administrative expense to increase in absolute dollars in future periods as we support our growing organization.

General and administrative expense as a percentage of revenue has remained relatively consistent. Because of the reasons stated above, we expect general and administrative expense as a percentage of revenue to increase in the near term.

**Comparison of the nine months ended September 30, 2013 and 2012****Revenue**

	<b>Nine Months Ended</b>		<b>% Change</b>	
	<b>September 30, 2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
Revenue				
Membership	\$47,598	\$34,036	40	%
Service provider	129,288	75,584	71	%
Total revenue	\$176,886	\$109,620	61	%
Percentage of revenue by type				
Membership	27	% 31	%	
Service provider	73	% 69	%	
Total revenue	100	% 100	%	
Total paid memberships (end of period)	2,378,867	1,656,768	44	%
Gross paid memberships added (in period)	993,556	862,014	15	%
Participating service providers (end of period)	44,876	33,209	35	%

Total revenue increased \$67.3 million for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012.

Membership revenue increased \$13.6 million primarily due to a 44% increase in the total number of paid memberships, partially offset by a 8% decrease in membership revenue per paid membership in the nine months ended September 30, 2013. The decrease in membership revenue per paid membership resulted primarily from growth in paid memberships in less penetrated markets where average membership fees per paid membership are lower. This decline also reflected the effect of allowing members in our more penetrated markets to purchase only those segments of Angie's List that are most relevant to them at a lower membership rate than applicable for the full service. The decrease in membership revenue per paid membership in the nine months ended September 30, 2013 also resulted from an increase from 90% to 93% of total memberships constituting annual and multi-year memberships.

Service provider revenue increased \$53.7 million to 73% of total revenue primarily as a result of a 35% increase in the number of local service providers participating in our advertising programs and an 8% increase in the average service provider contract value. Service provider revenue primarily consists of revenue from advertising contracts with service providers. E-commerce revenue of \$16.1 million and \$11.0 million is included in service provider revenue in

the nine months ended September 30, 2013 and 2012, respectively.

*Operations and support*

	<b>Nine Months Ended September 30,</b>			
	<b>2013</b>	<b>2012</b>	<b>%</b>	
	<b>(dollars in thousands)</b>		<b>Change</b>	
Operations and support	\$29,418	\$19,631	50	%
Percentage of revenue	17	% 18		%

Operations and support expense increased \$9.8 million for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. This increase was due in part to a \$4.3 million increase in call center costs as compared to the prior year period as a result of increased headcount. In addition, there was a \$3.5 million increase in publication costs as we increased the circulation of our *Angie's List Magazine* and \$1.7 million increase in credit card processing fees for member enrollment and service provider transactions.

*Selling*

	<b>Nine Months Ended September 30,</b>		<b>% Change</b>	
	<b>2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
Selling	\$65,582	\$42,974	53	%
Percentage of revenue	37	% 39	%	

Selling expense increased \$22.6 million for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. Service provider revenue increased 71% over the same period in the prior year.

Selling expense as a percentage of revenue decreased for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 primarily as a result of our transition to a new compensation structure for our sales force.

*Marketing*

	<b>Nine Months Ended September 30,</b>		<b>% Change</b>	
	<b>2013</b>	<b>2012</b>		
	<b>(dollars in thousands)</b>			
Marketing	\$75,870	\$71,316	6	%
Percentage of revenue	43	% 65	%	
Gross paid memberships added in the period	993,556	862,014	15	%
Marketing cost per paid membership acquisition	\$76	\$83		

Marketing expense increased \$4.6 million for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, due to a planned increase in national advertising to acquire new members.

Marketing expense as a percentage of revenue decreased from the prior year period due to total revenue increasing at a greater rate than marketing expense increased in absolute dollars.

**Technology**

	<b>Nine Months                      Ended September                      30,</b>			
	<b>2013</b>	<b>2012</b>	<b>%                      Change</b>	
	<b>(dollars in                      thousands)</b>			
Technology	\$19,349	\$12,223	58	%
Percentage of revenue	11	% 11	%	