Operations

Groupon's operations were divided into North America (United States and Canada) and International segments.

EXHIBIT 1

	Year Ended December 31					
	2009	% of total	2010	% of total	2011	% of total
	(dollars in thousands)					
North America	$ 14,540	100.0%	$ 200,412	64.0%	$ 634,980	39.4%
International	—	—	112,529	36.0%	975,450	60.6%
Revenue	$ 14,540	100.0%	$ 312,941	100.0%	$ 1,610,430	100.0%

SOURCE: Groupon, Inc. *10-K* (March 30, 2012), p. 45.

One trend that contributed to Groupon's growth was its investment in international markets. In 2009, the company's operations focused entirely on North America. In 2010, however, Groupon began looking abroad for growth, targeting key markets in both Europe and Asia. As a result, the International segment accounted for 36% of total revenues in 2010. As Groupon continued to see growth in 2011, the segment accounted for 60.6%, as shown in **Exhibit 1**. While this rapid expansion of the International segment contributed substantially to the company's growth, it also contributed to its annual net losses. In fact, management blamed the net loss in 2011 primarily on the "rapid expansion of [its] International segment during the year, which involved investing heavily in upfront marketing, sales and infrastructure related to the build out of [its] operations" in early stage countries.[27] Groupon's international segment often felt the impact of unfavorable foreign exchange rates.

To accompany this expansion, Groupon made changes to its distribution of resources, including corporate facilities and employees. The company's principal executive properties are described in **Exhibit 2**. Other facilities were located throughout the world.

The size and geographic distribution of Groupon's sales force over time is shown in **Exhibit 3**. Considering Groupon's two-pronged dependence on subscribers and on merchants, many of whom were very small businesses, the company maintained high-touch relationships with its merchants. In addition to its sales team, Groupon employed customer service representatives, editorial staff, marketing planners, merchant research and services teams, and "city planners" who created the schedules for each Groupon city every week.[28]

The growth in Groupon's sales force reflected international operations that began in May 2010 with the acquisition of CityDeal Europe GmbH. CityDeal was founded by Oliver Samwer and Marc Samwer, who have served since the acquisition as consultants and been extensively involved in the development and operations of Groupon's international segment.[29]

EXHIBIT 2

Description of Use	Square Footage	Operating Segment	Location	Lease Expiration
Corporate office facilities	550,000	North America	Chicago, IL	From 2012 through 2018
Corporate office facilities	30,000	International	Berlin, Germany; Schaffhausen, Switzerland	From 2012 through 2022

SOURCE: Groupon, Inc. *10-K* (March 30, 2012), p. 33.

EXHIBIT 3

Size of sales force	Mar. 31, 2010	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011	June 30, 2011	Sept. 30, 2011	Dec. 31, 2011
North America	128	201	348	493	661	990	1,004	1,062
International	—	1,080	1,224	2,080	2,895	3,860	3,849	4,134
Total	128	1,291	1,572	2,573	3,556	4,850	4,853	5,196

SOURCE: Groupon, Inc. *10-K* (March 30, 2012), p. 8.

Agreements under which Oliver and Marc Samwer provided consulting services were set to expire in October 2012 and October 2013, respectively.[30]

In January 2011, Groupon B.V., a subsidiary, entered into a joint venture along with Rocket Asia GmbH & Co. KG, an entity controlled by the Samwers.[31] Groupon B.V. became part owner of GaoPeng.com, which operates a group buying site offering discounts for products and services to individual consumers and businesses via Internet websites and social and interactive media.[32] GaoPeng.com began offering daily deals in Beijing and Shanghai in March 2011 and subsequently began offering daily deals in other major cities in China.[33]

Such acquisitions and joint ventures were an important part of Groupon's growth strategy. Groupon acquired eight firms in 2010, another nine in 2011, and an additional eight firms as of May 2012.[34]

Finance

Exhibits 4 and **5** show Groupon's consolidated statement of operations and consolidated balance sheet for the fiscal years ended 2008 through 2011.

For the years ended 2009, 2010, and 2011, Groupon reported revenue of US$14.5 million, US$312.9 million, and US$1.6 billion, respectively.[35] This represented an annual compound growth rate of 380%. From 2010 to 2011 specifically, revenue increased by US$1.3 billion. The company attributed this growth mainly to expanding the scale of its business both domestically and internationally through acquisitions, as well as by entering new markets. Initiatives that contributed to this expansion included an increase in marketing expenditures, as well as an increase in the company's sales force.[36]

Despite such significant revenue growth, operating income remained negative in 2011 (see **Exhibit 4**). Total operating expenses reached over US$1.8 billion in fiscal year 2011, an increase of 151.4% from that of 2010. Groupon attributed this rise to an increase of US$216 million in the cost of revenue due to increases in credit card processing fees, refunds, and editorial salary costs. Higher volumes of merchant partner transactions and a larger subscriber base contributed to these costs.[37]

The company's greatest increases in operating expenses, however, were in marketing, selling, general, and administrative expenses. For the years ended December 31, 2009, 2010, and 2011, the company reported marketing expenses of US$5.1 million, US$290.6 million, and US$768.5 million, respectively.[38] In its annual report, Groupon made it clear that such increases in marketing expenses have been necessary, stating that "Since our inception, we have prioritized growth, and investments in our marketing initiatives have contributed to our losses."[39] Management viewed investments in marketing as a necessary cost to acquire subscribers. When compared to the profits generated from these subscribers over time, the cost to maintain a subscriber was relatively inexpensive, as interaction was largely limited to e-mails and mobile applications. As its business continued to grow and became established in more markets, Groupon expected that its marketing expense would decrease as a percentage of revenue.

EXHIBIT 4

Groupon, Inc. Consolidated Statement of Operations (In thousands, except share and per-share amounts)

	Year Ended December 31			
	2008	2009	2010	2011
	(dollars in thousands, except share data)			
Consolidated Statements of Operations Data:				
Revenue (gross billings of $94, $34,082, $745,348 and $3,985,501, respectively)	$ 5	$ 14,540	$ 312,941	$ 1,610,430
Costs and expenses:				
Cost of revenue	88	4,716	42,896	258,879
Marketing	163	5,053	290,569	768,472
Selling, general, and administrative	1,386	5,848	196,637	821,002
Acquisition-related	—	—	203,183	(4,537)
Total operating expenses	1,637	15,617	733,285	1,843,816
Loss from operations	(1,632)	(1,077)	(420,344)	(233,386)
Interest and other income (expense), net	90	(16)	284	5,973
Equity-method investment activity, net of tax	—	—	—	(26,652)
Loss before provision for income taxes	(1,542)	(1,093)	(420,060)	(254,065)
Provision (benefit) for income taxes	—	248	(6,674)	43,697
Net loss	(1,542)	(1,341)	(413,386)	(297,762)
Less: Net loss attributable to non-controlling interests	—	—	23,746	18,335
Net loss attributable to Groupon, Inc.	(1,542)	(1,341)	(389,640)	(279,427)
Dividends on preferred shares	(277)	(5,575)	(1,362)	—
Redemption of preferred stock in excess of carrying value	—	—	(52,893)	(34,327)
Adjustment of redeemable non-controlling interests to redemption value	—	—	(12,425)	(59,740)
Preferred stock distributions	(339)	—	—	—
Net loss attributable to common stockholders	$ (2,158)	$ (6,916)	$ (456,320)	$ (373,494)
Net loss per share of common stock				
Basic	$ (0.01)	$ (0.04)	$ (2.66)	$ (1.03)
Diluted	$ (0.01)	$ (0.04)	$ (2.66)	$ (1.03)
Weighted average number of shares outstanding				
Basic	333,476,258	337,208,284	342,698,772	362,261,324
Diluted	333,476,258	337,208,284	342,698,772	362,261,324

SOURCE: Groupon, Inc. *10-K* (March 30, 2012), p. 38.

HIBIT 5

upon, Inc. Consolidated Balance Sheets (In thousands, except share and per-share amounts)

	December 31	
	2010	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 118,833	$ 1,122,935
Accounts receivable, net	42,407	108,747
Prepaid expenses and other current assets	12,615	91,645
Total current assets	173,855	1,323,327
Property and equipment, net	16,490	51,800
Goodwill	132,038	166,903
Intangible assets, net	40,775	45,667
Investments in equity interests	—	50,604
Deferred income taxes, non-current	14,544	46,104
Other non-current assets	3,868	90,071
Total assets	$ 381,570	$ 1,774,476
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 57,543	$ 40,918
Accrued merchant payable	162,409	520,723
Accrued expenses	98,323	212,007
Due to related parties	13,321	246
Deferred income taxes, current	17,210	76,841
Other current liabilities	21,613	144,427
Total current liabilities	370,419	995,162
Deferred income taxes, non-current	604	7,428
Other non-current liabilities	1,017	70,766
Total liabilities	372,040	1,073,356
Commitments and contingencies (see Note 8)		
Redeemable noncontrolling interests	2,983	1,653
Groupon, Inc. Stockholders' Equity		
Series D, convertible preferred stock, $.0001 par value, 6,560,174 shares authorized and issued, 6,258,297 shares outstanding at December 31, 2010, and no shares outstanding at December 31, 2011	1	—
Series F, convertible preferred stock, $.0001 par value, 4,202,658 shares authorized, issued, and outstanding at December 31, 2010, and no shares outstanding December 31, 2011	1	—
Series G, convertible preferred stock, $.0001 par value, 30,075,690 shares authorized, 14,245,018 shares issued and outstanding at December 31, 2010 and no shares outstanding at December 31, 2011, liquidation preference of	1	—

EXHIBIT 5
(Continued)

December 31	2010	2011
Voting common stock, $.0001 par value, 1,000,000,000 shares authorized, 422,991,996 shares issued and 331,232,520 shares outstanding at December 31, 2010 and no shares outstanding at December 31, 2011	4	—
Class A common stock, par value $0.0001 per share, no shares authorized, issued, and outstanding at December 31, 2010; 2,000,000,000 shares authorized, 641,745,225 shares issued and outstanding at December 31, 2011	—	64
Treasury stock, at cost, 93,328,656 shares at December 31, 2010 and no shares outstanding at December 31, 2011	(503,173)	—
Additional paid-in capital	921,122	1,388,253
Stockholder receivable	(286)	—
Accumulated deficit	(419,468)	(698,704)
Accumulated other comprehensive income	9,875	12,928
Total Groupon, Inc. Stockholders' Equity	**8,077**	**702,541**
Noncontrolling interests	(1,530)	(3,074)
Total equity	**6,547**	**699,467**
Total liabilities and equity	**$ 381,570**	**$ 1,774,476**

SOURCE: Groupon, Inc. 10-K (March 30, 2012), p. 65.

Selling expenses reported in **Exhibit 4** consisted of "payroll and sales commissions for sales representatives, as well as costs associated with supporting the sales function such as technology, telecommunications, and travel."[40] For the years 2009, 2010, and 2011, total selling, general, and administrative expenses were reported at US$5.8 million, US$196.6 million, and US$821.0 million, respectively.[41] Groupon attributed these increases largely to the expansion of its global sales force as well as investments in technology and corporate infrastructure.[42] Like its marketing expense, Groupon expected that selling, general, and administrative expenses would decrease as a percentage of revenue as its operations matured over time.

The underlying concern regarding Groupon's financials was that the company realized a total net loss in income every year since its inception. For the years 2008 through 2011, these losses amounted to US$1.5 million, US$1.3 million, US$413.3 million, and US$297.7 million, respectively.[43] As shown in the statement of retained earnings in **Exhibit 6**, these losses led to an accumulated deficit of US$698.7 million in 2011. In this light, management decided not to pay dividends, intending instead "to retain all of our earnings for the foreseeable future to finance the operation and expansion of our business."[44]

EXHIBIT 6
Consolidated Statement of Retained Earnings (thousands)

Report Date	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Previous retained earnings (accumulated deficit)	(419,468)	(29,828)	(2,574)	(1,032)
Common stock dividends	—	—	20,338	—
Preferred stock dividends	—	—	5,575	—
Forfeiture of dividends	(191)	—	—	—
Retained earnings (accumulated deficit)	(698,704)	(419,468)	(29,828)	(2,574)

SOURCE: Mergent Online.

In 2012, Groupon continued to see exceptional growth in revenues. **Exhibit 7** compares the results of operations from the quarter ended March 31, 2012 to the quarter ended March 31, 2011. For the first quarter of 2012, the company reported revenues of US$559.3 million, compared to US$295.5 million for the first quarter of 2011.[45] Total operating expenses continue to rise in 2012, increasing by US$106.9 million from the first quarter of 2011, reflecting significant increases in cost of revenue and selling expenses. Groupon made strides toward cutting marketing spending in 2012, reporting US$116.6 million in marketing expenses compared to US$230.1 million in the first quarter of 2011. The company attributed this expense cut to a strengthening brand name that allowed it to become more established in markets around the globe. As of March 31, 2012, Groupon reported 36.8 million active customers, more than double the 15.3 million reported on March 31, 2011.[46] The amount of revenue that Groupon received per customer had not increased, however; revenue per average active customer was

EXHIBIT 7

Groupon, Inc. Condensed Consolidated Statements of Operations (In thousands, except share and per-share amounts) (unaudited)

	Three Months Ended March 31	
	2011	2012
(Restated)		
Revenue (gross billings of $668, 174 and $1,354,800, respectively)	$ 295,523	$ 559,283
Costs and expenses:		
Cost of revenue	39,765	119,498
Marketing	230,085	116,615
Selling, general, and administrative	142,821	283,583
Acquisition-related	—	(52)
Total operating expenses	412,671	519,644
(Loss) income from operations	(117,148)	39,639
Interest and other income (expense), net	1,060	(3,539)
Equity-method investment activity, net of tax	(882)	(5,128)
(Loss) income before provision for income taxes	(116,970)	30,972
Provision (benefit) for income taxes	(3,079)	34,565
Net loss:	(113,891)	(3,593)
Less: Net loss (income) attributable to noncontrolling interests	11,223	(880)
Net loss attributable to Groupon, Inc.	(102,668)	(4,473)
Redemption of preferred stock in excess of carrying value	(34,327)	—
Adjustment of redeemable noncontrolling interests to redemption value	(9,485)	(7,222)
Net loss attributable to common stockholders	$ (146,480)	$ (11,695)
Net loss per share:		
Basic	$ (0.48)	$ (0.02)
Diluted	$ (0.48)	$ (0.02)
Weighted average number of shares outstanding:		
Basic	307,849,412	644,097,375
Diluted	307,849,412	644,097,375

SOURCE: Groupon, Inc. *10-Q* (May, 15, 2012), p. 5.

reported at US$72.41 on March 31, 2011, compared to US$71.77 on March 31, 2012.[47] Rather than adding revenue solely by acquiring more customers, Groupon was searching for ways to increase the amount of revenue it received per subscriber from its existing base.

"We Don't Measure Ourselves in Conventional Ways"

Investors and the Securities and Exchange Commission began to question management's reporting of Groupon's financials. Although Groupon disclosed all financial data required by the SEC, management stressed the importance of other, more unconventional metrics. The company, which said that it did not "measure [itself] in conventional ways," placed more importance on metrics such as adjusted consolidated segment operating income, free cash flow, and gross billings, rather than net income.[48] Groupon reported net losses in each of the past three years and believed that unique metrics better reflected its financial progress.

Groupon defined adjusted consolidated segment operating income (CSOI) as "the consolidated segment operating income before new subscriber acquisition costs and certain non-cash charges."[49] It believed that adjusted CSOI was an important measure of the performance of its business since adjusted CSOI excluded expenses that management believed were not indicative of future operating expenses. Free cash flow was defined as cash flow from operations reduced by "purchases of property and equipment"[50] and although the measure could be revealing, Groupon acknowledged that it was a non-GAAP financial measure. Gross billings, another proprietary metric, was the gross amount collected from customers for Groupons sold. Management viewed gross billings as a measurement of growth, but its use in revenue recognition was a source of controversy. Wall Street observers argued that Groupon's use of these non-GAAP measures was simply a strategy to portray its financials favorably in light of its lack of profitability.[51]

In 2011, Groupon had to restate its earnings for the three months ended March 31, 2011 "to correct for an error in its presentation of revenue."[52] Groupon historically reported its revenue as the gross amounts billed to its subscribers. The revision required revenue to be restated as the net of the amounts related to merchant fees. This error prompted the company to report a "material weakness" in its internal control over financial reporting.[53] The Condensed Statement of Operations shown in **Exhibit 8** for the three months ended March 31, 2011, was restated to show the net amount the company retained after paying merchant fees. Several other income statement expenses were changed as well to align with the reporting of revenue on a net basis.

Then, on March 30, 2012, the company announced that it would also have to restate earnings for the fourth quarter of 2011 after a higher-than-expected number of customers demanded refunds.[54] Going forward, management planned to improve its internal controls for financial reporting. With significant errors and multiple financial restatements present in

EXHIBIT 8

Groupon, Inc. Notes to Condensed Consolidated Financial Statements for the Three Months Ended March 31, 2011, In Thousands (Unaudited)

	As previously reported (unaudited)	Restatement adjustment	As restated
Revenue	$ 644,728	(349,205)	$ 295,523
Cost of revenue	$ 374,728	(334,963)	$ 39,765
Marketing	$ 208,209	21,876	$ 230,085
Selling, general, and administrative	$ 178,939	(36,118)	$ 142,821

SOURCE: Groupon, Inc. *10-Q* (May 15, 2012), p. 11.

Groupon's first year as a publicly traded company, investors continued to question the company's disclosure methods and the reliability of its internal reports. Five federal class action securities complaints, and six federal and two state stockholder derivative lawsuits had been brought against Groupon and its current and former directors and officers since the restatement.[55] The addition of new members of the Board of Directors with accounting and financial expertise was considered necessary to regain investor confidence.[56]

Information Technology

Groupon did not equivocate regarding technology's importance to its operations and business strategy:

> We employ technology to improve the experience we offer subscribers and merchant partners, increase the rate at which our customers purchase Groupons, and enhance the efficiency of our business operations. A component of our strategy is to continue developing and refining our technology.[57]

Almost all of the company's communication with both customers and merchant partners was electronic. It was important for Groupon to adopt an information system that would facilitate efficient communication with both merchants and customers. Groupon used a common information technology platform that enhanced communication while also providing management and merchant partners the ability to track deal performance and analytics for demographic data and capacity. The platform included business operations tools to track internal workflow; applications and infrastructure to serve content at scale; dashboards and reporting tools to display operating and financial metrics for historical and ongoing deals; and a publishing and purchasing system for consumers.[58] Groupon used the platform only in North American operations in 2012, but management planned to merge the system with the company's more segmented international information technology platforms. While there was no timetable in place for this move, Groupon reported that it planned to "enable greater efficiencies and consistency across [its] global organization."[59]

Information system platforms, as well as websites, applications, and back-end business intelligence systems were hosted at data centers in Florida, Texas, California, and overseas in Asia and Europe. For security purposes, Groupon used commercial antivirus, firewall, and patch-management technologies to protect and maintain systems located at the data centers. To ensure the security of its website as well as customer transactions, Groupon also invested in intrusion and pattern detection tools, as well as Secure Socket Layer (SSL) to provide encryption for transferring data. These security measures were easily scalable to accommodate increasing numbers of subscribers.[60]

Marketing

Since the company's founding, marketing had been at the core of Groupon's business strategy. Management's aggressive marketing efforts fueled revenue approaching US$2 billion in three years of existence. A first mover in the daily deal industry, Groupon owned number-one market share in 37 of 48 countries served as of the first quarter of 2012.[61] Specifically in North America, Groupon held 53% market share, as of the second quarter of 2012.[62]

Critical to Groupon's strategy was growing its subscriber and customer base. As stated earlier, the vast majority of its investments to fuel this growth were through online marketing initiatives: search engine marketing, display advertisements, referral programs, and affiliate marketing.[63] Groupon also marketed to merchant partners to grow the number and variety of deals it could offer customers. To further increase merchant partner growth, Groupon utilized