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EXPE - Q2 2018 Expedia Group Inc Earnings Call

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OVERVIEW:

EXPE reported 2Q18 YoverY revenue growth of 11%.

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PRESENTATION

Operator

Good day, and welcome to the Expedia Group Q2 2018 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Michael Senno, Vice President of Investor Relations. Please go ahead, sir.

Michael Senno - *Expedia Group, Inc. - VP, Investor Relations*

Good afternoon, and welcome to Expedia Group's financial results conference call for the second quarter ended June 30, 2018. I'm pleased to be joined on the call today by Mark Okerstrom, Expedia Group's CEO and President; and Alan Pickerill, our CFO.

The following discussion, including responses to your questions, reflects management's views as of today, July 26, 2018 only. We do not undertake any obligation to update or revise this information.

As always, some of the statements made on today's call are forward looking, typically preceded by words such as we expect, we believe, we anticipate or similar statements. Please refer to today's earnings release and the company's filings with the SEC for information about factors which could cause our actual results to differ materially from these forward-looking statements.

You will find reconciliations of non-GAAP measures to the most comparable GAAP measures discussed today in our earnings release, which is posted on the company's Investor Relations website at ir.expediagroup.com. And I encourage you to periodically visit our IR website for other important content, including today's earnings release.

Unless otherwise stated, all references to cost of revenue, selling and marketing expense, general and administrative expense and technology and content expense exclude stock-based compensation and depreciation expense, and all comparisons on this call will be against our results for the comparable period of 2017.

One additional item to note. Starting last quarter, we are presenting financial results both for Expedia Group in total and excluding trivago in order to provide increased transparency on the underlying performance of our transactional businesses. You will find reconciliations for non-GAAP measures, excluding trivago, in our earnings release.

Finally, a reconciliation of adjusted EBITDA guidance to the closest corresponding GAAP measure is not provided because we are unable to predict the ultimate outcome of certain significant items without unreasonable efforts. These items include, but are not limited to, foreign exchange, returns on investment spending and acquisition-related restructuring expenses. As such, the items that are excluded from our non-GAAP guidance are uncertain, depend on various factors and could have a material impact on GAAP results for the guidance period.

And with that, let me turn the call over to Mark.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Thanks, Michael. As we sit here halfway through the year, I'm pleased with our progress thus far. We delivered solid financial results while continuing to push forward on several critical initiatives aligned with the 3 strategic themes I outlined late last year, becoming more locally relevant on a global basis, becoming more customer-centric and speeding up the pace of execution and innovation.

And although it's still early days in our transformation, I'm pleased to say that we are making great strides along our new path. Looking forward, though our industry remains highly dynamic, we are increasingly confident in our execution capabilities and are optimistic about the opportunities they can unlock for us in this $1.6 trillion market.

Turning to the second quarter. Gross bookings increased 13%, revenue grew 11% and adjusted EBITDA was up a very healthy 18%. Overall room nights grew 12% year-over-year. And smoothing out the impact from the shift in Easter timing, first half total lodging stayed room nights grew 14%. HomeAway continued to deliver strong results, increasing stayed room nights 35% in the first half of 2018. All told, we have great momentum heading into the back half of the year.

Our brand teams are making good progress in better optimizing direct marketing spend, and that was evident in the balance between healthy room night growth and profitability in the second quarter. We plan to keep leveraging our data-driven approach to marketing optimization while at the same time continue to aggressively drive our global expansion agenda.

As we strive to become more locally relevant on a global basis, we continue to build momentum on the property acquisition front, adding over 60,000 new properties to our global lodging portfolio in the quarter, excluding HomeAway listings. That number includes a further acceleration in the pace of property acquisition in our priority markets, where we are firmly in execution mode, and we are seeing encouraging early signs in our performance. Collectively in these markets on a booked basis, both total and domestic room night growth accelerated in the second quarter. We're optimistic that the momentum we are seeing in these markets will continue to build as we move through the year and into 2019.

In addition to the 60,000 newly-acquired properties in the quarter, we also integrated an additional 20,000 HomeAway listings into our core lodging platform, bringing our total property count available to all Expedia Group brands to more than 750,000 as at the end of the quarter. Overall, we remain on track to directly add at least 180,000 new properties to the core platform in 2018 in addition to integrating more HomeAway properties throughout the year.

HomeAway ended the quarter with over 1.7 million online bookable listings, an increase of about 20% from last year. Over 800,000 of them are now instantly bookable. We do expect the continued shift to instant bookability to be a nice tailwind to conversion over time, further enhancing the HomeAway marketplace. The HomeAway team has been ramping up the velocity of innovation on both sides of the platform. Over the past few quarters, they've rolled out impressive lineup of industry-leading, supplier-facing tools aimed at helping our partners optimize the productivity of their listings. We continue to be very happy with the progress in HomeAway. They're making incredible strides in the transformation and in doing so, are positioning HomeAway and Expedia Group very well to capitalize on the significant global opportunity in alternative accommodations.

Gross bookings growth at Egencia accelerated to 18% in the quarter and stayed room nights grew 21%, their highest growth in nearly 2 years. The sales team at Egencia continues to produce strong results, signing over $460 million of new business for another quarterly record. So we're seeing good returns from the investments we've made in the team. With nice momentum in sales and a differentiated product offering, we believe Egencia has a significant opportunity to continue to gain share in the managed corporate travel market for a long time to come.

trivago continued to face difficult comps and challenges in the second quarter as it navigates changes to dynamics in its marketplace. As the trivago team highlighted yesterday, they are now taking a more balanced approach to trade-offs between top line growth and profitability, with more of a bent towards profitability than in the past. Combined with easing comps, trivago expects adjusted EBITDA results to improve in the second half of the year.

Overall, though lots of hard work remains, we have made good progress in the first half of the year. We are executing at a much improved level and are gaining traction with our key initiatives all aimed at positioning Expedia Group for healthy growth well into the future.

With that, I'll turn it over to Alan.

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Thanks, Mark. We again posted healthy top line trends in the second quarter with lodging revenue, including both hotel and HomeAway up 14% on stayed room night growth of 12%. As we expected, total lodging room night growth decelerated from the first quarter, primarily due to a headwind from the shift in Easter timing and difficult year-over-year comparisons, which were in part driven by more aggressive marketing spend in last year's quarter.

Excluding HomeAway, revenue per room night increased 1% compared to average daily rate growth of approximately 5%. That gap was over 100 basis points smaller than last quarter, and we expect that to continue to narrow slightly in the second half of the year. HomeAway grew both gross bookings and stayed room nights 33% in the quarter with revenue increasing 32%. Transaction revenue growth remained robust at over 60% and accounted for over 80% of HomeAway's revenue for the first time in the second quarter. Subscription revenue declined 25%, roughly in line with our expectations for the year.

HomeAway showed nice leverage on overall cost and posted very strong adjusted EBITDA in the quarter, almost doubling year-over-year to $78 million. In addition to lapping some of last year's hiring increases, the cost leverage was primarily related to slower growth in marketing expenses than recent quarters. After building out our performance marketing function last year, we continue to refine and improve our capabilities and gain more data-driven insights.

With a fully functioning marketing platform and team now in place, we are also better able to optimize our spend to appropriately balance top line growth and profitability, which we did nicely in Q2. I would note that as we continue to refine our performance marketing capabilities at HomeAway and comp against the ramp up in marketing investments over the last year, we do anticipate some continued deceleration in gross bookings growth as we move through the year. Overall, HomeAway remains on track for very healthy top and bottom line growth in 2018.

Total advertising and media revenue decreased 9% for the quarter due to significant declines at trivago. Our Media Solutions business delivered another quarter of solid double-digit growth.

Air revenue was up 10% on a 6% increase in air tickets sold, 4% growth in revenue per ticket. Similar to last quarter, air revenue growth benefited from the reclassification of distribution fees from contra revenue to cost of revenue and the reclassification of certain customer refunds from air revenue to insurance. These changes took effect in the first quarter and will have an impact for the rest of 2018, although they are neutral to our overall profitability. Other revenue increased 16% in the second quarter, largely reflecting continued growth in travel insurance.

Adjusted expense growth decelerated across each category and drove consolidated adjusted EBITDA margin expansion of 90 basis points. In line with our expectation for the full year, cost of revenue grew faster than revenue in the quarter. The accounting change I mentioned earlier related to air distribution fees contributed around 150 basis points to the growth while cloud expenses added about 250 basis points. We continue to make good progress migrating our lodging stack to the cloud, balancing speed with prudent cost management and a seamless customer experience. As we've moved through the year, we have developed greater capabilities to more dynamically optimize costs. As a result of these efforts, our 2018 cloud expenses are tracking a bit below the $170 million we previously discussed.

Looking ahead to 2019, our early estimates, which are subject to change, call for total cloud spend to be over $250 million, balanced by a nice offset in free cash flow in the form of avoided data center CapEx. In addition, we expect cloud expenses to continue to be split roughly 60-40 between cost of revenue and technology and content, similar to the past several quarters.

Total selling and marketing expenses increased 7% with direct expenses up just 5% for the second quarter. We had an easy comparison to the 30% increase in direct expenses in the second quarter of 2017 as we made aggressive marketing investment decisions across several brands last year.

In addition, we continue to make progress on optimizing direct marketing spend as we strive to deliver incremental quality top line growth, although we do begin to lap some of those benefits here in the third quarter. Indirect selling and marketing growth also moderated as we lap the initial investments in the sales team at Egencia. Growth does remain elevated, given the increased headcount associated with our supply initiative. And we expect that to remain the case for the rest of the year. In total, we now expect total adjusted selling and marketing expenses to grow in line with or slightly slower than revenue for the full year.

Technology and content expenses were up 19% in the second quarter. Inorganic impact from acquisitions and our cloud migration contributed a total of over 450 basis points to that growth. We expect technology and content expense growth to reaccelerate slightly in the second half of the year as we continue to invest in our e-commerce platform and product innovation across the organization.

As expected, growth in general and administrative expenses slowed significantly compared to last quarter as we started to lap last year's staffing increases, notably at trivago and HomeAway. The second quarter marks the last of any meaningful inorganic impact from recent acquisitions, which added over 200 basis points to G&A growth in the quarter. We continue to anticipate growth in general and administrative expenses to moderate further in the second half of 2018, though we now expect that growth to be roughly in line with revenue growth for the full year. The slightly higher-than-planned G&A expense growth largely stems from operating in an increasingly dynamic global tax and regulatory environment.

Moving down the income statement. Depreciation expense growth continued to slow, increasing 12% in the quarter in part due to benefit from lower data center-related CapEx. We also saw leverage on net interest expense, and our adjusted tax rate came in at 16% for the quarter as we benefited from the lower U.S. corporate tax rate. All of that added up to very robust adjusted earnings per share growth of 55%. We expect adjusted EPS to grow faster than adjusted EBITDA for the rest of the year.

On the capital allocation front, year-to-date, we returned a total of over $540 million to shareholders, including over $450 million in share repurchases at an average price of just under $112. Our year-to-date repurchase total is already higher than any full year amount since 2014. We also recently raised our dividend for the seventh consecutive year. Going forward, we intend to maintain the same balanced approach to capital deployment, opportunistic M&A and returning capital to shareholders through share repurchases and our dividend.

Turning to our financial expectations for the year. We are increasing our full year guidance range and now expect consolidated adjusted EBITDA growth of 7% to 12%. That growth would be 300 to 400 basis points higher, excluding cloud. Note that while we are pleased with our results to this point, we still have a lot of work to do with more than 100% of our dollar growth in adjusted EBITDA ahead of us in the second half of the year. We have strong operational momentum and believe we are well positioned to continue delivering healthy top line and profit growth in the near term while investing in key initiatives to drive sustained growth over the long term.

With that, operator, we're ready to take our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Justin Post from Bank of America Merrill Lynch.

Justin Post - *BofA Merrill Lynch, Research Division - MD*

I have 2. First on marketing spend. Is the industry getting more efficient? And is that helping your overall returns on marketing? How are the ROIs going? And how do you feel about that right now? And then -- and second, HomeAway, looks like bookings did decelerate. You called that out. How are you choosing between just spending on marketing to try to drive that bookings growth versus driving profitability?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Great. Thanks, Justin. In terms of marketing efficiency, listen, there has been no secret that some of the large players in the industry, ourselves included, have been pulling back and I think cooling off some of the auction heat that may have been taking place previously. I would also say that just from an Expedia Group perspective, the level of sophistication that we've got now in terms of really applying the modern data science techniques, leveraging a lot of the capabilities that we've got by moving a lot of our data infrastructure up into the cloud has just allowed us to be a lot smarter in a way that, not only that we're bidding for traffic, but also in the way that we're able to really understand what traffic is incremental. So I think it's a combination of a couple of things. I think also that we're in an industry where the real big brands, the brands that consumers [met], that consumers care about and that they've got experience with are starting to mean something, and I think that, as a result, can lead to more traffic shifting over to direct-branded channels, whether they're through apps or whether a result of branded marketing.

In terms of HomeAway. Listen, I wouldn't read too much in the slowdown in gross bookings or Alan's guidance that we would expect some deceleration. I think it largely, it's a comps issue and we're trying to maintain a balanced approach. And I would just put your attention to the long-term opportunity. As a reminder, the Phase 1 of HomeAway that we're in right now is really about transitioning the business from an off-line listing business to an e-commerce business. We have not been focused on international expansion. We have not been focused on acquiring new listings, although we've acquired hundreds of thousands since the acquisition and since last quarter, we have 100,000 new listings sign up with us, that's really going after that. And Phase 2 is really about that. It's about international expansion. It's about property acquisition. It's about moving into the urban opportunity. And that's all ahead of us. So we feel very comfortable with the trajectory of HomeAway. And really, what you see here is just the team tuning its muscles around making the right trade-offs here in Phase 1.

Operator

Moving on, we'll take our next question from Eric Sheridan from UBS.

Eric James Sheridan - *UBS Investment Bank, Research Division - MD and Equity Research Internet Analyst*

Maybe 2, if I can. Alan, for you, calling out there on the cloud, I want to understand, investors ask us all the time sort of how we should think about cloud spending versus benefits from cloud migration playing out as we move through this year and into next year. Is there any framing you can give around the way investors should think about that? And Mark, a good, solid commentary on the pace of investing in inventory. How should investors be thinking about the investments in inventory leading to either higher marketing efficiency, better conversion, faster growth in terms of room nights? What should we be watching for, for how that plays out over the next sort of 12 to 18 months?

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes, sure, Eric. I would say on the cloud side, I mean, we've talked a little bit about some of these data points already. If you look at our data center CapEx spend in 2016, it was about $180 million. It went down to about $50 million in 2017, and that's the actual decline. We are obviously avoiding additional CapEx as well. I've talked in the past about the fact that before we had made the decision to migrate to the cloud, we were on the cusp of having to make decisions around building out additional data centers. That's all been taken off the table and avoided as is. And so we are already seeing, I think, pretty good trade-offs in avoided CapEx relative to what we're spending for compute in the cloud. On top of that, there's just a ton of operational benefits associated with it. The speed is much better, latency reduced, the ability to deploy code very quickly, the ability to test algorithms and roll out algorithms is much better in the cloud. The disaster recovery is much, much better with cloud, where if you have a -- we already had a situation where we had a brownout on Brand Expedia. We were able to roll it out into the cloud seamlessly, roll it back once the issue had been resolved. So there's a ton of operational benefits as well. But we like it both from a total cash flow over time perspective and then from a product perspective, we think it's a no-brainer.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Great. And then I'll take the one on inventory. There's basically a 2-leg benefit here that you see. Step one is as you acquire the new properties, you're entering new auctions and performance marketing channels. Generally, what you see in that phase is you see an acceleration in room night growth for the markets that you're going after. The second phase in it, however, is once you start to get better density of properties, you do see higher repeat rates. You do see more customer loyalty. And with that comes generally higher conversion rates and better marketing efficiency. We're not expecting to see that second phase in a particularly noticeable manner here in year 1. It is something that in years 2 and 3, we would expect to see particularly in our, of course, our priority markets that we're focused on this year.

Operator

Moving on, we'll take our next question from Brian Nowak from Morgan Stanley.

Brian Thomas Nowak - *Morgan Stanley, Research Division - Research Analyst*

I have 2. Just going back to the supply initiative. I want to talk a little bit about the sort of the incremental investment from here. You talked about sort of pushing into your target market and seeing good early results. Can you just talk us through a little bit through the -- what you think about incremental investment in the supply initiative as you go into 2019? And then sort of a similar question around Away, and Away profitability is very strong in the quarter. Mark, you talked a little bit about kind of Phase 2. How should we think about the timing of when you decide to push into Phase 2 and start investing more in HomeAway?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Great. Thanks, Brian. In terms of incremental investment in the supply initiative, I'd just say that the way that we're operating based upon the results we've seen so far is really the new normal as opposed to taking a more distributed approach to our supply acquisition and a more metered approach. I would just say the expectation from here on is we will take a more concentrated approach, not only to just supply acquisition, but this whole thing is under the umbrella of this concept of locally relevant on a global basis. So on our wave 1 markets, the big push here is around acquiring supply because we do believe that we had a reasonably large gap versus the next competitor in these markets. But as we look out into future waves, in some cases, it's not going to be as supply centric. In some cases, it's going to be a more concerted effort and maybe not incremental resources, but a concentration of resources, into things like translation, payment types, content, et cetera. And so as we look out into 2019, we're going to be looking through the back part of this year around what are going to be our priority markets? Where are we going to invest? And based upon those decisions, it'll dictate where in terms of focus areas -- in terms of functional focus areas the investments will go, whether it's, again, property acquisition or one of these other levers. The good news, though, is that, of course, we've already got a pretty a significant investment sitting here in our 2018 base. And so this one-time big step up, even if we do another significant investment next year, is going against what will be at that point easier comps. And secondly, with the step up, again, the big benefit, as I responded to Eric, is really in the second year. And so the expectation is that we'll start to see some of the benefits of our big push this year flow through in the second year and that will, in effect, start to fund some of the investments that we'll be making in future waves.

In terms of HomeAway and timing, listen, I think, we're going to do what I think we've done historically, which is try to strike the right balance. That's what we're doing here in 2018. And I think we'll see as things go through. We haven't done our 2019 planning yet. And again, the HomeAway team is very focused on getting Phase 1 here nailed. And they're doing a great job, by the way. And then as we move through the back part of this year, we'll start to think about what comes next and what parts of Phase 2 do we really start getting serious about in 2019.

Operator

Our next question will come from Mark Mahaney from RBC Capital Markets.

Mark Stephen F. Mahaney - *RBC Capital Markets, LLC, Research Division - MD and Analyst*

I think, Mark, you mentioned that room night growth accelerated in some of the priority markets. Can you tell us what learnings you're getting from those markets that you could apply to the nonpriority markets to get room growth -- room night growth to accelerate there? Or why is room night growth -- what did you do to get room night growth accelerated in those markets? Was that just the lodging procurement? And then that HomeAway EBITDA margin that you had in the quarter, that looked pretty positive. Is there something that tells you that you can -- you want to sustain it at that level? I know you're balancing as you just talked about growth and profitability there, but do you feel like you've reached a -- perhaps after a lot of investment, a new, new level there that you could work up from there?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Great. Thanks, Mark. I'll take #1 and turn #2 over to our trusty CFO. In terms of room night growth acceleration, listen, we talk a lot about the supply acquisition side of this. But of course, in these markets, we're also making sure that we've got content right, payment types right, et cetera. It is really the whole package. The investment, though, is in these markets pretty concentrated into supply. But of course, we're also just trying to build just much more significant cross-platform operational rigor so that we can shrink the time from a time when a property gets added to the time that it's live on the site and the time that it's actually marketed in metasearch and search engine marketing channels. So it's really a whole host of things that we're doing. This is built, by the way, on the back of years of hard work in terms of getting our supply acquisition machine into shape, getting our customer experience into shape, being multicurrency, multi-language, building great landing page, development capabilities and of course, developing much better online marketing capabilities. And really, what we're doing now is just executing across the board on an end-to-end basis. All of those discrete basis -- functions much more coordinated and, I'd say, operationally rigorous way.

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes. And then, Mark, on HomeAway, I think, first of all, I would just remind you, it's a hyper seasonal business. So I wouldn't necessarily look at the margin in one quarter and kind of use that as a proxy for ongoing margins. The vast -- the big chunk of adjusted EBITDA that they will earn will come in Q3, which results in some fluctuation -- seasonal fluctuations in margins throughout the year. I don't think we're set yet on exactly what the normalized margin ought to be for HomeAway. I think we're happy with the margin they delivered in 2017. We're happy with what we expect that to look like in 2018. We think that the opportunity is such that we can grow the top line at healthy rates, use some of that to invest in the business, deliver healthy profits and profit growth. But some of that's going to depend on specific decisions that we make as we move forward. As Mark mentioned, as we get through the 2019 planning, we'll look at some of these initiatives and make some decisions about what the right investment levels are. We have talked historically about how we think, there's probably no reason that a business like HomeAway couldn't deliver EBITDA margins that look something like the EBITDA margins that you see at a hotel-only OTA. But I wouldn't put a pin in that. That's a directional aspiration and we'll see how things pan out over time. But we -- to be honest, we don't spend a ton of time tearing it apart because we -- we're confident that we will deliver healthy margins for HomeAway.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Yes, and I would just add, too, that, again, we're not focused particularly strongly on margins. We're really looking to drive adjusted EBITDA, free cash flow and adjusted EPS growth for a long period of time. And we're really trying to strike the best balance to get a sustained growth rate to be deliverable over the long term.

Operator

Moving on, we'll take our next question from Deepak Mathivanan from Barclays.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Two questions. First, as you guys optimize the performance marketing channels over the last several quarters, have you noticed any meaningful changes in the booking window or whether there's expansion or contraction? And how does that play into the stayed room night growth during the last couple of quarters? And then the second question, Alan, was there any FX impact on the guidance? I know the U.S. dollar significantly reversed course. I was wondering if the guidance would have been better, if not, for the U.S. dollar appreciation.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

So Deepak, just on the booking window piece, we do see some ebbs and flows less so associated with our performance marketing movements and actually, more so just in terms of the mix of our business. And there's a couple of mix factors that move it around. I think, first of all, HomeAway generally has a longer book-to-stay window. They're generally looking at larger homes. And even when they're not larger homes, they're taking bookings into places that don't have 20 rooms or don't have 100 rooms -- that simply have 1. So people are more likely to book that further in advance and that they make sure that they get the place that they want to stay. So as the mix of our lodging room nights between HomeAway and the core lodging business ebbs and flows, you could see a lengthening of the window, particularly at certain parts of the year. The second thing is that as we push more into the domestic markets in a number of these countries, like the priority markets that we're in right now, it does open up the opportunity for local travel to happen on a much more significant basis of our overall mix. And in many cases, local travel is more last-minute booking. It's weekend trips, for example, where you're driving somewhere or you're taking a short flight as opposed to the overall mix of our business that has traditionally skewed a little bit more to the international side. So just a couple of things to keep in mind. Again, we're not seeing anything super significant right now. But over time, we can imagine these types of things take hold. Alan, do you want to take the FX one?

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Sure. Yes, Deepak. So on FX, yes, I mean, I think you're right to point it out. The fact is that FX has been a helper in the first part of the year here, although the dollar has strengthened more recently. And so the amount that we estimate it to help us for full year 2018 has come down relative to when we guided earlier this year. It's one of many factors considered as we put the full forecast together. But you're right to point out directionally that it has become less of a tailwind than we thought. And at current rates, it looks like it kind of crosses over here kind of July, August timeframe and becomes kind of neutral to a head -- a slight headwind in the back half of the year.

Operator

Moving on, we'll take our next question from Kevin Kopelman from Cowen and Company.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

So you had a pretty substantial 400 basis points headwind to the core hotel revenue from lower revenue take rates. Can you call out the key factors driving that headwind? And it looks like it's going to improve a little bit in the back half, but how do you see it over the longer term?

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes. So as I said in my prepared remarks, the gap between the hotel business itself or the business, I should say the business excluding HomeAway, the gap between ADRs and revenue per room night was still there. It was a narrower gap than we had last quarter, although the comp got a little bit easier. I mean, we said essentially, we are seeing that gap in the 200 to 400 basis point range. As a reminder, the factors that contribute there are when we have taken -- historically, when we have taken changes to our margins and annualizing those changes, as we add new properties in new markets and we add them at the revised lower rates, that can blend the mix down as well, although that, we look at it as being new business. So still all gravy. The loyalty programs are an impact. A weight on revenue per room night, we think of it largely as a marketing channel, but the accounting rules require us to show it as contra revenue. So that has been there as the loyalty programs have grown. A few other factors play in there. FX can play in. Expedia funded discounts and coupons, refunds and cancellations, those things all play into it as well. Ultimately, for this year, we're comfortable in the 200 to 400-basis-point range. And then as we move forward into 2019 and beyond, we'll kind of reassess the factors that are contributing there. The one thing I should say is that we do get questions from time to time about whether just an ongoing push by hotel chains to try to get lower commission rates or economics will play into this. We're not looking at it like that. We reset our commission rates purposely over the course of the last number of years. We think we're currently at very fair rates and giving good value for the economics that we get, and so we don't see that as something that will pressure those rates going forward.

Operator

Next we'll hear from Lloyd Walmsley from Deutsche Bank.

Lloyd Wharton Walmsley - *Deutsche Bank AG, Research Division - Research Analyst*

I have 2 on the Add-On program. Looks really interesting and very differentiated. So just starting with the first one, it's probably early, but what are you seeing in terms of just early uptake there? Are you seeing a lift in attach rate on hotel? And do you have a sense for how much of that is incremental versus just a shift in how people are booking? And then, I guess, the second one on the same topic would be, as you run these programs, we understand they're mostly net rate programs, but wondering if that's a drag on take rates or unit economics? And maybe give us a sense of what percentage of hotel partners are participating in that program?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Thanks, Lloyd. Listen, it's early, but early indications are very solid. We're seeing higher customer attach rates and higher -- essentially, higher room right growth than otherwise would seem. So we think that it is at least in part incremental. But it's really hard for us to get conclusive on that. What we do know, which is what you called out, it's a highly differentiated product. It blends 2 wonderful things about Brand Expedia, which is the convenience of having everything all in one place. So if you change plans or things move around, you've got 1 quote "travel agent" to deal with and they can solve all your problems. And secondly, it does result in overall lower cost travel, which of course travelers absolutely, absolutely love.

In terms of take rates, we don't see this as a significant driver of deteriorating unit economics. We're not going to get into the specifics of how all of this works. I would just say that we've had a very successful package product for a very long period of time and this is an alteration on the traditional package. In terms of hotel participation, listen, one of the things that hotels and lodging partners generally love about the Expedia Group platform is that it is incredibly targetable. And this gives our hotels the ability to, in a very specifically fenced way, to target customers, not out in the open, but to target customers that we know are going to a certain place with a special deal. And so the hotels that participate, which is the vast majority of them, I think are finding it to be a great program, just like they have our traditional package program. Generally, when hotels get booked with a flight or something else, you get lower cancellation rates. You get longer lengths of stay, and that's generally a great thing for our hotel partners. So again, it's very early. We like it because it's differentiated, both on the customer side of the platform and on the partner side of the platform, and it delivers great value to both of them. So we're optimistic about what it can do for us.

Operator

Moving on, we'll take our next question from Jed Kelly from Oppenheimer.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director and Senior Analyst*

The HomeAway transaction commissions continue to improve. Are you starting to see a higher mix of paid per listings? And if so, is that being driven more by individual owners or professional property managers? And then, I guess, on the comment in the release that travelers on HomeAway grew over 40% year-to-year. Is there any way to unpack that on how many of that growth was driven by members with new profiles?

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes, we'll try to be helpful here, Jed. I don't think we're going to get to the level of detail that you're looking for. I think on the listings, it's fair to say that we are seeing, in terms of actual listings, we're seeing an ongoing shift from subscription to pay per booking that's been going on for a while. I think I mentioned last quarter it remains true. Now that -- in spite of that, we still do have a disproportionate skew of bookings to the subscription products, and that is to be expected as we -- or listings as we move through this transition. And so that's kind of ongoing. I don't have the data on, and I'm not sure we would share it either on the -- how many of the members were members with new profiles. I don't know, Mark, if you'd...

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Well, I would just say that we continue to believe that on both sides of the platform, we're getting -- obviously, you can see it, we're getting many more hosts signed up to the platform based upon our traffic growth and our transaction growth. We think we're getting significantly stronger traveler growth as well.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director and Senior Analyst*

And then, I guess, just a follow-up on the property manager comment on the outside growth or the skew. I mean, how much of that is being driven by property managers, say, with over 1,000 of bookings on HomeAway or 1,000 of listings on HomeAway?

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes, I don't think we want to get into that level of detail.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Yes, I mean, I would just say that generally, the large property managers are the ones that are generally more likely and were some of the earlier adopters to online bookability and to essentially commission-based pay per booking listings with the individual owners, particularly of large homes, generally preferring or sticking around for the longest time on the subscription model. But it really is a pretty dynamic environment right now with the changes that HomeAway is making to their marketplace, the incentives are constantly shifting and the performance that property owners and property managers can get from being in the pay-for-performance model are increasing over time. And so we expect to continue to see a continued shift across essentially all host categories.

Operator

Moving on, we'll take our next question from Naved Khan from SunTrust.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Just a couple. So was there any impact from the World Cup or GDPR on the room nights? And as we think about the back half, what's the right way to think about room night growth given that the first half was maybe a bit noisy? And then I have a follow-up.

Alan R. Pickerill - *Expedia Group, Inc. - Executive VP, CFO & Treasurer*

Yes. So we've talked about this in the past. I mean, when you have big events like this, it could be the Olympics, it could be the World Cup, sometimes it's natural disasters, there are changes in travel patterns. We do think when you have an event as large as the World Cup, you do see a situation where a decent percentage of the population is preoccupied with that event. And so you may see overall bookings slow a bit during a certain period of time. But usually, we would expect that to come back in the form of pent-up demand. And ultimately, we don't think it has anything to do with kind of the longer-term trajectory of the business or anything we're doing strategically. And I should say, too, when you have the event in a particular region or country, in this case, Russia, you do see a pickup in travel into that location as well.

As far as thinking about room night growth in the back half of the year, we're not going to get into the specifics. I would say there are a couple of things to consider. One of them is that we will continue with this effort to optimize marketing spend. Now I want to be clear that the effort there, first and foremost, is to root out marketing spend that we can test for and decide is not incremental. And if we're right, then when we don't make that spend, a decent portion of that volume still comes to us. Because by definition, what we're trying to do is take out spend that we -- for room nights, we would have gotten anyway. We probably do lose a little bit around the edges though, and around the margins. So we think that could have an impact on room night growth. The -- in terms of the contribution from priority markets, I think Mark mentioned earlier, first and foremost, we're going to look for the result of room night growth in total and for domestic travel in our priority markets and just monitor how that's impacting those markets. At what point it gets big enough to move the needle on the whole business? We're not entirely sure, but we're not counting on a big impact in the back half of the year. And then the last factor I would probably throw out there is just, as a reminder, we had some tough storms in the back half of '17. That negative impact was more skewed towards EBITDA than it was room night growth because what happens in those storms is you end up with a lot of cancellations and refunds, you're giving customers for room nights that you booked and you actually had in the system. So bigger impact on profits than it had on the room night growth, but could provide a minor tailwind in the back half of the year.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Okay, that's very helpful. And then just a quick follow up. So I guess, can you give us some additional color on the move to Progressive Web App for Brand Expedia. Just on the hotel side, how much of the traffic was on this PWA previously? And what are the benefits that you may have seen?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Sure. So we're -- we've now essentially got the whole hotel piece, at least hotel shopping for Brand Expedia on the Progressive Web App in terms of mobile. And we are really ramping it up through the first -- actually, really throughout the quarter. And really, the benefit -- the biggest benefits we see are largely in respect to just the speed. So particularly in places outside the U.S. where we had latency issues speed is significantly faster. And then it really is just -- it's a coding framework, which allows us to really start to get closer to giving app-like experiences in mobile web experiences. And so that's harder for us to measure now, but it is something we expect will give us benefits over a long time to come. And we are now building more functionality and will be building more of the other lines of business and more of our applications on to the PWA app as well. So we can expect that to give more benefits for us as we move through this year and into 2019.

Operator

Moving on, we'll take our next question from Peter Stabler from Wells Fargo Securities.

Peter Coleman Stabler - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

A couple on brand, if I could. Mark, in the past, you've talked about the power of the Expedia brands and the percent of traffic and bookings that come to you directly. Just wondering if you're able to offer a little color on how that might vary across the family, on the core brands versus the regional brands versus HomeAway and VRBO. And whether you're seeing any impact in the market from the increased brand marketing efforts of some of your close competitors. And then just a quick follow-up on the cloud. You spoke earlier about the operational benefits. Is there any way to offer us any sort of quantification on improvement you might see -- expect in terms of conversion, whether it's 5 bps here, 10 bps there? Or any sort of quantification that could help us understand these operational benefits?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Yes, you're welcome. So in terms of the power of the Expedia brands, again, the brands in our portfolio, we think, are really amongst the, if not, the world-leading brands in travel. Many of them, such as the Expedia, Hotels.com, have literally had billions of dollars of brand spend, spent to build up customer loyalty in addition to just giving customers great experiences over the long history of those brands. There is variations across the family. And a lot of the variation really comes down to how aggressively we're pushing international expansion. Because in the more mature markets, where you've got a fully locally relevant product, you really generally have a significantly larger portion of your business that comes to you directly. So think about Brand Expedia U.S., Hotels.com U.S., Orbitz U.S., Travelocity U.S., really getting the lion's share of their business through direct and branded channel such as direct type in or the mobile applications or e-mail, et cetera. But as you move further away from your more mature markets and you get into markets, which you are sort of in a growth phase for or new markets, the percentage of direct branded traffic goes down and really, the game is to build locally relevant products in each of these markets. And when you do that, really start to push more of that traffic to come to you via branded channels and more direct.

I'd say in terms of competitor activity, it is not a major change. I mean, we have seen over the course of the last particularly 5 or 6 years, various players come in and out of television advertising. If you take the U.S. for example, you saw over the course of the last 5 years, trivago come in very significantly essentially backed by us. You saw Orbitz and Travelocity pull back. You saw Booking.com come in I think, first 2013. And then you saw TripAdvisor come in and pull back. So it's always been a very dynamic environment. But for us, I think television advertising, brand spend, it's always been a key part of our formula. And we're just going to keep doing our things. And we think our capabilities there are -- really have the potential for us to really differentiate ourselves, not only in the U.S., where it has been, but as we increasingly become locally relevant in a lot of these other markets, also bringing our expertise globally.

In terms of the cloud operational benefits, it's hard for us to completely quantify this for you, largely because we're doing a ton of things to drive conversion rates up. What I will do, though, is just underscore for you the operational importance of this. We are essentially rewriting our code base so that it can operate in the cloud, so they can move seamlessly between AWS and our own data centers and potentially from one cloud environment to another cloud environment over time. We have the brightest engineers, we think, in the industry. No one is doing what we're doing at scale. We are not taking this lightly. But the reason we're doing it is not only because of the financial benefits that Alan is talking about, but it is the operational benefits. And if you want to look at some quantification of this, I would just point you to the marketing optimization efforts that we're doing right now. We've got some of, we think, the leading data scientists now working on data sets up in the cloud environment who are getting to essentially real time recomputation of our algorithms. We're building self-learning algorithms and we're able to spool up massive amount of processing capacity essentially on-demand and then bring it back down, and that is actually helping us deliver some of these marketing optimization benefits that you're seeing. So it goes beyond just conversion. It goes right to the core of almost everything we do. Our PWA application, for example. I mean, that is a cloud native app. A lot of the speed benefits that we talked about, which do deliver conversion benefits outside of, particularly outside of the U.S., this is all enabled by the cloud. So again, we are at the cutting-edge of this. It's a big thing that we're doing. We do already see the operational benefits. But I think we're really just scratching the surface in terms of what we can do.

Operator

(Operator Instructions) Moving on, we'll go with Douglas Anmuth from JPMorgan.

Douglas Till Anmuth - *JP Morgan Chase & Co, Research Division - MD*

Mark, I know you talked about how the marketing landscape has pulled just the auction market back coming down on performance. Do you think this is the new normal going forward? And recognizing that you're focused on optimizing efficiency, have this also created some opportunities now for you as well?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Well, it's hard to say in the travel industry whether anything is the new normal. It's always dynamic. It's always been dynamic. I think the one thing, of course, that has created opportunities for us is just our increased capabilities. I mean, we have in terms of just bidding more effectively, measuring incrementality with more precision. Again, largely driven by the data-driven approach and really massive data sets that we're being able to manipulate and compute up into the cloud environment. And I think that's something that is the new normal. I think the question is, of course, with all of this is you can build competitive advantage, but to sustain it, you've got to keep moving. So we're not standing still. We're going to continue to evolve our capabilities in this area. And assuming we do that, I think we can hold this as the new normal. But again, what happens in the overall competitive environment and what happens in these auctions, it's really hard for us to tell at this point.

Operator

Moving on, we'll take our next question from Heath Terry from Goldman Sachs.

Heath Patrick Terry - *Goldman Sachs Group Inc., Research Division - MD*

This is maybe a little bit along the same lines as Doug's question. But to the extent that we've seen your competitors pulling back on their marketing spend, there's generally been a more negative impact to bookings growth for them. Here, this quarter, bookings growth were essentially flat and you guys still saw a pretty significant improvement in sales and marketing efficiencies. So is there something different about the strategy that you're using or the way that you're thinking about this in terms of how you're benefiting from the sort of systemwide reset in ROI targets? And then just if you could maybe update us on any progress that you're making in terms of your work with hotels on leveraging their direct booking pricing models as potentially something that's either having an impact on the business one way or the other or something that you guys could potentially incorporate into some of your channels over time?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Thanks, Heath. It's hard for us to compare what we're doing to what our competitors are doing because unfortunately for us, we don't know what they're doing. But I can tell you a little bit about what we're doing and why we may be in a different spot. I think, first of all, when you think about hot advertising auctions, it's generally in auctions where you've got a couple of players who have comparable products, if you will, and they start to bid against each other and that can create situations where you sort of destroy industry economics. I think that -- there could have been some of that happening in markets where both us and our larger competitor and maybe some other players were both relatively strong. We're trying to find, of course, these auctions and situations where that type of activity isn't incremental to us and where, hey, the customer were to come back to us together. But the good news/bad news story for us is that there are very few markets where that's the case. I mean, we have not built locally relevant product offerings in that many markets yet around the world. If you look at the total number of hotel and alternative accommodations properties out there, there's millions of them. We talked about us having this quarter 750,000. So we've got a whole bunch of what I would call just global expansion to do outside of our core mature markets so that as we pull back or find marketing spend, which is not incremental, because we've already got such powerful brands in a lot of these markets and customers are going to come to us anyways. We are able to pull that back, not have a significant impact to bookings, but at the same time be able to actually drive growth in a really healthy way, which is just get more customers and new customers to the platform and more properties to the platform and other products because simply, we're just adding more selection and more availability, and that creates great network effect. So that's what our -- that's what we're doing.

Listen, in terms of the hotel direct pricing model and any impact to our business. Again, we've been saying this for a long time. We have not seen an impact to our business, our customers are brand agnostic. That's why they come to us. We don't like the practice. We think that it's not a great thing for the industry, it's not a great thing for our value proposition if there's a big message out there that you get lower prices elsewhere. But so far, our customers haven't really cared because they don't really look for a specific branded hotel. We think that's a great opportunity for a lot of our partners, and a lot of our more forward thinking partners have taken advantage of that and have used our channel as a way to sign up new customers and new loyalty members. And the partners that we have had signed up to that program have generally, and I think without exception, cited great results. We are always having conversations with additional partners. We love to test this stuff. So I would invite all of our partners, large and small, to come forward, and we'll do a test with you and see if it works. Again, for the most part, I think without exception, it's been a good thing for us. So again, I think this is an evolving area for us. And we're hopeful, as with the large chains and the small chains, that we can collectively find win-win situations where we can drive incremental value for everyone across the platform.

Operator

And we'll take our final question from Mike Olson from Piper Jaffray.

Michael Joseph Olson - *Piper Jaffray Companies, Research Division - MD & Senior Research Analyst*

You talked about the priority markets for new inventory. What are those markets where you're adding and saw acceleration? I could take a guess, but if you could say more specifically. And then looking beyond alternative accommodations, what's your appetite for other booking products, like tourist attractions, et cetera? Is that maybe just there's too much fish to fry in hotel and alternative accommodations to bother with that at this point?

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Oh, Mike, I can't tell you my secret. So I won't tell you. But it will -- I bet you, you've got a pretty, pretty good guess. In any event, we're happy with the progress there. I would just tell you that they are important markets out there. It's the beginning. It's the wave one. We'll be doing other markets around the world and in future years. So for competitive reasons, I'm not going to call out exactly what they are.

In terms of appetite for other products beyond hotel, alternative accommodations, listen, it's a voracious appetite. I mean, we have been the ones that have been building and investing this multiproduct platform for years. We -- this year, we'll spend approaching $1 billion just on the P&L in our tech platform investments. It's what we do. And in doing that, we've built the world's travel platform and yet, we're still early days in terms of building real liquid marketplaces across all the lines of business. Yes, we are investing right now and making sure that we've got a locally relevant product in the hotel and alternative accommodations marketplace in priority countries, and we're going to move that around the world. But short to follow, we're making sure that we do that as well in those priority markets across air, car, activities, cruise. And we love the cruise business. I think we're just at a very early, early stages. So we've gone through our multiyear investment cycle. I think we're uniquely positioned to build incredible marketplaces, not only in a standalone basis, but also increase the sophistication within which we can cross-sell and create network effects across all of these different product categories. I think if you look out over the course of the next 2 to 5 years, that's going to be an increased focus for us. It's something that our customers love. And you can see a piece of it already with Add-On Advantage. It's also something that our partners love as well.

Operator

And at this time, I'd like to turn the conference back over to Mark Okerstrom for any additional or closing remarks.

Mark D. Okerstrom - *Expedia Group, Inc. - President, CEO & Director*

Great. Thanks. Well, firstly, I just want to thank everyone for listening in today. And secondly, I just really want to thank the entire Expedia Group team. In a very short time, we have made some very significant changes in the way that we operate at Expedia Group, and I am more impressed than ever with our incredible employees around the world. I know I speak for all of them when I say that we are so excited about the enormous opportunities in front of us.

With that, I'll turn it back over to the operator.

Operator

And at this time, that will conclude today's conference. We do thank you for your participation, and you may now disconnect.
