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EXPE - Q4 2017 Expedia Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Expedia, Inc. Q4 2017 Earnings Call. (Operator Instructions) And at this time, I'd like to turn the floor over to Ms. Kristy Nicholas, acting Head of Investor Relations. Please, go ahead, ma'am.

Kristy Nicholas - Expedia, Inc. - Head of Investor Relations

Thanks, Greg. Good afternoon, and welcome to Expedia, Inc.'s financial results conference call for the fourth quarter and full year ended December 31, 2017. I'm pleased to be joined on the call today by Mark Okerstrom, Expedia's CEO and President; and Alan Pickerill, our CFO.

The following discussion, including responses to your question, reflects management's views as of today, February 8, 2018, only. We do not undertake any obligation to update or revise this information.

As always, some of the statements we made on today's call are forward-looking, typically preceded by words such as we expect, we believe, we anticipate or similar statement. Please refer to today's press 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.



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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.expediainc.com. And I encourage you to periodically visit our IR website for other important content, including today's earnings release and our latest investor deck.

I would like to remind you that beginning in Q1 '17, we include HomeAway on-platform gross bookings and property nights in our operational metrics, and such balances have been added to prior year gross bookings and lodging room nights for clean comparison. 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 2016.

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, acquisition-related or restructuring expenses. As such, the items that are excluded from our non-GAAP guidance are uncertain, dependent on various factors and could have the material impact on GAAP results for the guidance period. And with that, let me turn the call over to Mark.

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

Thanks, Kristy. 2017 was a year of change for Expedia across many dimensions. And though the year did not end up as we planned from a financial perspective, we hit some impressive milestones and made huge progress in a number of areas. Importantly, we spent the last quarter aligning the organization strategically and operationally to execute on our ambitious plans, and we are now firmly in execution mode. We know the work we are doing as a group will set us up on a path deliver to deliver to our full potential in this massive industry of ours. Before providing more details about our strategic themes for 2018, I wanted to cover some of the highlights from Q4.

Our global growth brands: Brand Expedia, Hotels.com, Egencia and Expedia Affiliate Network continue to grow stayed room nights at a healthy pace, turning in 17% growth this quarter on a combined basis. HomeAway grew room nights 30%. Strong growth at these brands was offset slightly by our regional brands, optimized for profitability, leading to overall lodging room night growth of a solid 15%. Our booked room night growth in Q4 was a bit faster than stayed and accelerated from Q3 rates. Though it's early, I would add that we are encouraged by top line trends that we are seeing so far this quarter.

Egencia grew gross bookings 15% and revenue 18% for the quarter. After signing the quarterly record in new client business during Q3, Egencia immediately broke that record by signing approximately \$405 million of new business during the fourth quarter, bringing its total signings to approximately \$1.4 billion for 2017. Clearly, our investments to ramp up the Egencia sales machine are starting to bear fruit.

In 2017, HomeAway advanced on its transition to an e-commerce business with on-platform gross bookings hitting \$8.7 billion for the year, up 46%. Adjusted EBITDA of \$202 million compares quite favorably to its \$125 million of adjusted EBITDA back in 2015, the year of our acquisition. HomeAway continues to deliver solid financial performance while investing heavily back into building the business for the long term.

trivago grew revenue on a stand-alone basis 18% for the quarter, although foreign-exchange grew roughly half of that growth. We continue to believe that trivago offers a strong value proposition to both customers and advertisers and that the business will continue to grow over the long term. Note, however, trivago does face extremely tough revenue and profitability comps through the first half of 2018.

Before I turn it over to Alan, I want to spend a bit of time discussing a few of our key strategic themes for 2018, each of which I highlighted last quarter. We're going to accelerate growth by being locally relevant on a global basis. We'll be more customer-centric, putting the A back into OTA. And we'll speed up the pace of execution and innovation across our group.

On becoming locally relevant on a global basis, we identified a number of high-priority markets for our initial efforts. In these markets we're already hard at work, dramatically increasing our hotel supply to ensure that no matter where customer wants to go, we have the perfect place for them to stay.



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In our high-priority markets, we're also making more aggressive content and localization investments, focusing product, technology and infrastructure initiatives to benefit these markets and bolstering our marketing efforts as we improve the breadth and quality of our offering. I'm happy to report that we have hired about 95% of the sales force required for our aggressive property acquisition push in these markets, and we expect to complete the onboarding of these team members in short order. All told, in 2018, we plan to directly add nearly 2x the number of properties to our Core OTA platform this year versus what we achieved in 2017. HomeAway additions to the platform will be on top of that number.

Over the years, we have observed strong network effects develop where we can intelligently match deep supply coverage, broad marketing and brand awareness with great localized user experiences. We aim to replicate those powerful effects around the world, and in doing so, drive greater growth and share gains for many years to come.

Second, on becoming more customer centric or putting the A back into OTA. One of our key goals in 2018 is to put ourselves in our customers' shoes. We want to go beyond just making it easier for customers to shop and book on our sites. Our objective is to provide customers with increased confidence that if things go wrong on the trip, which does happen in this messy travel industry of ours, or plans change, we will do what we can to help. We'll also look to wow our customers with exciting new products and features such as our new shopping cart experience on Brand Expedia, which is live and being tested against a portion of U.S. traffic right now. We'll also push for greater customer personalization and increase innovation in voice and chat.

Finally, we will continue to accelerate the pace of execution and the innovation across our organization. We have revamped our goal-setting and prioritization processes for strong cross-organizational alignment and simplification. We are already seeing this translate into faster, more effective and more efficient execution throughout the organization.

On the pace of innovation front, our cloud migration is unlocking a new level of velocity. For example, on our new cloud-based applications, we are deploying new code more than 2,000 times per day, a stark contrast to the daily or weekly release cycles of yesteryear. As we migrate a greater portion of our mission-critical compute into the cloud environment through 2018, we expect to continue unlocking opportunities to move faster.

To be clear, our strategic themes are squarely aimed at the massive global opportunity ahead of us. Travel is a \$1.6 trillion industry, and we operate the largest multiproduct two-sided platform in the world.

Our role is clear and our potential is enormous. We are the only truly global travel platform that can orchestrate the movement of any person from any place to any place by almost any means and offer them access to their ideal experiences throughout the journey. That's an awesome responsibility and an incredible opportunity, and we are only at the early stages of what we can become.

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

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

Thanks, Mark. For the fourth quarter, gross bookings growth accelerated to 14%, driven by booked lodging room night growth, while revenue growth decelerated to 11%, partially due to HomeAway's further transition from a subscription- to a transaction-based model. Adjusted EBITDA declined 9% as we began ramping up key investments while putting a drag on fourth quarter profitability, it helped us gain a head start on 2018. These investments included hiring for our lodging supply and content teams and migrating more of our compute to the cloud.

Lodging revenue, including both hotel and HomeAway, grew 11% for the fourth quarter, driven by stayed room night growth of 15%. In the hotel business, revenue per room night declined 3%, while average daily rates grew 2%, a gap which was slightly larger than last quarter given a harder comparison versus Q4 of last year. We do expect this gap to narrow throughout 2018 driven by increasingly stable margins.

HomeAway gross bookings grew 47% while revenue grew 16%. The sequential deceleration of revenue growth primary reflects HomeAway's hyper-seasonal trends, difficult comps and ongoing impacts of their transition to a transaction-based business. Fourth quarter transactional revenue grew 71% to \$130 million, while subscription revenue declined 33% and ended the year at 27% of revenue, in line with our expectations. HomeAway



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adjusted EBITDA decreased 28% to \$31 million in the fourth quarter, reflecting the confluence of revenue deceleration and increased investments in the business.

Advertising & media revenue of \$214 million increased 13% for the quarter due to continued growth at Expedia Media Solutions and trivago. Note that in 2017, we eclipsed \$1 billion in total advertising & media revenue.

Air revenue was essentially flat in the fourth quarter on a 3% increase in air tickets sold, offset by a 3% decrease in revenue per ticket. All other revenue increased 14% in the fourth quarter, reflecting growth in travel insurance and car rental products.

For the full year, our expense growth was largely in line with our target P&L with cost of revenue leveraging nicely at 8%, and each of our technology and content and general and administrative expenses growing 10% for the full year, compared to revenue growth of 15%. Selling and marketing grew faster than revenue at 22% as we mixed into some higher-cost channels and sought to drive global growth.

For the quarter, however, each of our expense categories grew faster than revenue. On cost of revenue, we spent \$18 million for the quarter on cloud, representing year-over-year growth of \$16 million. We also built out operations to support our partner solutions business with a combination of these items leading to deleverage in this expense line.

In line with our expectations, selling and marketing grew faster than revenue for the quarter driven by growth at trivago, Brand Expedia, Expedia Affiliate Network and HomeAway. We continue to believe in employing a strategic mix of both performance-based and brand marketing activities across our brands and around the world. Our investments in headcount in our lodging supply and Egencia teams also contributed to higher growth.

Technology and content grew slightly faster than revenue during the quarter, primarily due to headcount added at HomeAway to drive innovation on supplier and traveler-facing products and technology.

General and administrative expenses also grew faster than revenue on headcount growth. As we scale up some staffing at HomeAway and trivago, it also reflects the inorganic impact of SilverRail.

In terms of capital deployment, we were pleased to have repurchased 1.3 million shares in the fourth quarter, bringing our 2017 repurchases to 2.3 million shares for a total of \$294 million. In addition, we paid \$176 million in dividends for the year. We expect to remain net buyers of our stock over the long term. And we'll have a balanced approach between the opportunistic M&A, share repurchases and dividends.

Our financial statements include estimates of the effect of the recent U.S. tax reform, including the transition tax on cumulative foreign earnings and the revaluation of our net deferred tax liability to the newly enacted 21% U.S. corporate tax rate. Overall, we recorded a small net benefit on a U.S. GAAP basis for the impact of the tax act, and we do not expect transition tax to result in any meaningful impact to our cash taxes.

There are a number of other provisions that do not impact 2017 but will impact 2018 and beyond. We continue to analyze those provisions, expect further guidance from the Treasury Department, and will be able to share more information on the impact of these factors as we move through 2018.

Turning to our financial expectations for full year 2018. On a consolidated basis, we expect adjusted EBITDA growth of 6% to 11%. Our guidance is based on current foreign exchange rates, which have been pretty volatile of late.

In terms of the shape of the year for 2018, with the seasonality of our consolidated business in mind, including the seasonality of HomeAway and the back-end weighting of trivago's plan this year, we are forecasting all of our adjusted EBITDA dollar growth to come in the second half of the year. As a reminder, in our Core OTA business and at HomeAway, we invest in selling and marketing to generate bookings ahead of the busy travel season, with the revenue recognition occurring at the time of the stay. This impact will be amplified by our planned investments for 2018, including accelerated supply acquisition and cloud migration, among others. Please note that on a consolidated basis, all of these impacts will be particularly acute in Q1, where we expect adjusted EBITDA to be down significantly year-over-year, including the adjusted EBITDA losses for both HomeAway and trivago.



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We remain intent on driving leverage and fixed costs over the long term. Given our ambitious investment plans, we expect the following for full year 2018. We expect cost of revenue to grow slightly faster than revenue due to expanding owner and property manager support and new payment options at HomeAway, customer operations for our partner solutions business and the increase in the investment in cloud. We expect technology and expense to grow significantly faster than revenue, primarily due to an increase in cloud and the impact of key investments. More specifically, in total, we expect cloud spend of \$170 million for 2018, roughly split 50-50 between cost of revenue and technology and content.

As we invest aggressively in supply, we also expect to utilize higher-cost performance-based channels to drive demand across our global growth brands, causing sales and marketing expense to grow faster than revenue. Additionally for HomeAway, we continue to ramp investment in performance-based and brand marketing on the back of better overall capabilities and improved transaction-based monetization. We expect general and administrative expenses to grow solidly slower than revenue.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And first from Piper Jaffray, we have Mike Olson. (Operator Instructions)

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

Just one question for me, guys. So one of the things that we heard from investors during the quarter was a concern that there would need to be, I guess, further downward EBITDA revisions. And I guess, that proved to be the case. As you look forward, do you feel like you've now set a good level for 2018? Or is there a real potential that as you go through the year, you may identify further investment areas that could drive EBITDA growth lower still as we kind of migrate through 2018?

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

Yes. It's Mark. We feel good about our guidance. As a reminder, in Q3, what we wanted to do was give people a framework for understanding how we were thinking about planning for 2018. We had not finished planning the time. As you know, Q3 is not a time where we usually give the next-year guidance. It was really just a framework. And what we were doing was steering people towards this sort of lower end of our historic performance of 10% to 20%. You'll note from our guidance, which is 6% to 11%, that 10% is squarely within that range. And of course, we do detailed planning exercise. We've got everything planned out. And our expectation is we'll be able to hit the number within that range.

Operator

(Operator Instructions) Next from Oppenheimer, we do have Jed Kelly.

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

Great. It looks like HomeAway bookings accelerated versus the prior couple of quarters. Is there anything you can call out that's either working from a site conversion or higher performance marketing? And then following up, I guess there's been a couple of recent vacation rental property manager conferences that sort of spoke to some of the displeasure around some of the recent HomeAway changes, especially around the attribution. How would you assess your relationship with some of the large property managers right now?



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

Thanks, Jed. Well, the gross bookings acceleration is really a combination of a lot of great stuff that HomeAway is doing. As you recall, there were a bunch of pieces to the transition. One of them was around monetization, and we introduced the traveler fee. Now we've lapped over that because we introduced that in 2016. It was really creating the conversion engine, improving travel experiences and owner and property manager experiences, and they've been executing really well against that, and then, of course, solving this problem of people taking bookings off platform. And so what you're seeing is a combination of all these things working. And when they work, it allows HomeAway to start stepping on the gas in sales and marketing. And that's what they've been doing. They're now in a position where, having worked with a lot of our Core OTA businesses and actually have a leader in their online marketing function who used to be the leader for Hotels.com, they've really got the technology stack in place, and they're executing on the online marketing playbook. And that is driving some very nice growth. Now the flip side of that, of course, is that it can put pressure on near-term profitability. And Alan spoke about that in terms of Q1. And what we're finding, interestingly, is that unlike our Core OTA business, a lot of times for these big whole homes, we're seeing bookings not only booked into the busy summer months, like Q3, which is a high, high peak quarter for them, we're actually seeing things start to slip into future years as well. So we're starting to get a better handle on how to forecast these things, but it is really a combination of a lot of great work.

With respect to the property manager displeasure and how those are going, listen, I would say that, broadly speaking, the property manager and owner community is adjusting to the changes. They're finding ways to use the platform to benefit them. And generally, things are moving in a very, very constructive direction. But of course, because HomeAway is making so much change and implementing change to this platform, they're always trying to find ways to incent the right behaviors or correct problems that are resulting in leakage or poor behaviors. And you can see some of the things they've done in terms of charging fees for off-platform bookings, some of the movements they've made in terms of taking subscription pricing it up just a little bit, all really intended to create the right marketplace activity so that HomeAway can continue on the path it's on, which is driving and growing and ultimately, continue to drive great bookings and great revenue for all of their property managers and owners. So we think the relationship continues to be good and constructive, and we're very happy with the progress there.

Operator

Next question from Morgan Stanley, we have Brian Nowak.

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

Just to -- understanding that the comments on the previous call were kind of a soft guidance, you talked about a few exceptions. You've delivered EBITDA growth between 10% and 20%. I guess as you think about this year and kind of the investments, has anything changed in the way you think about the pace of the investments over the next couple of years, now versus then? Are you spending more on cloud this year than you thought you would? Are you spending more on hotel supply than you thought you would? And if anything's changed? Then how do you think about the potential benefits of the increased supply coming through the platform? How long does that take?

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

Yes. Sure. So I'd say that everything was just an inch, probably an inch more in cloud than Alan had guided to. I think our supply investments, an inch more, but not anything dramatically different, so broadly in line with what we are expecting there. The difference is now that we've actually got things planned out, and I think that the timing is more clear to us at this point.

In terms of benefit of supply and timing, again, we're going to hire folks up here. We've got just about all of them hired. They'll be onboarded, the bulk of them, by the end of the first quarter. They'll get to work. And some of them are ready to work, signing up new properties, hopefully, for the high season. And our expectation is that we should start to see some impact in terms of room night growth towards the back part of the year. But the real benefit for adding more supply really comes in the second year and in subsequent years, when you can really, one, see the full year impact of the properties you've added, and secondly, create the real network effects of essentially having everything that a customer could possibly want



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who lives in a given region and having them come back to you directly again and again and again through direct channels and generally cheaper channels. And that's a longer impact. We would hope to see that in 2019 from our priority markets this year. But at this point, there's no guarantees.

Operator

Next, we have Justin Post from Merrill Lynch.

Justin Post - BofA Merrill Lynch, Research Division - MD

Great. Given that you've guided HomeAway to \$300 million in the past, I'm wondering if you could help us understand what kind of the outlook is for that now and if you had any write-down related to that. I wouldn't think so, but just wondering on that. And then secondly, I think you said in your prepared remarks that booked nights growth was better than stayed in the quarter. I wonder if you could help us with the differential there.

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

Yes, Justin. This is Alan. So on HomeAway, the things that have changed for us in terms of our original guide on -- or target, I would say, for 2018 adjusted EBITDA are principally around the migration of the business to the cloud. And we had said last quarter, we thought that would be about \$30 million of spend in 2018, and we continue to think that's the right range. And then the other side of it really are just kind of the level of investments that you might see in brand marketing and performance marketing. That business has finally become one that has true unit economics, true travel transaction e-commerce business and has stood up a proper search engine marketing effort. And so our inclination is for them to push on that and to push on growth. And keep in mind, they have a very long booking window, so sometimes we're seeing -- we sometimes see bookings on HomeAway that are more than a year out, for example, and that's a little bit different than what you typically see in the hotel business. So that's -- those are the primary differences from our prior guide on HomeAway. As far as the booked room nights are concerned, we saw -- sorry, Justin. Was this specific to HomeAway or in general?

Justin Post - BofA Merrill Lynch, Research Division - MD

In -- for the total company.

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

In general, yes. So we did see a little bit of acceleration on the booked room nights in Q4. It's -- it was faster than Q1. I wouldn't look at it as being a very steep curve, but it was trending in the right direction. We just wanted to call out that we were seeing good healthy trends there.

Operator

Next from Goldman Sachs, we have Heath Terry.

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

Great. Curious, Mark, can you give us a sense on the higher costs that we're seeing in sales and marketing? How much of that or how do you guys think about how to separate what is investment versus what is simply higher operating costs? We've been seeing this trend for a while, not just with your business but everyone in the travel space of the cost of traffic or the cost of customer acquisition going up. How do you sort of distinguish between investment versus just a lower ROI because of the more competitive environment that we're in for traffic? And then to the extent that we're hearing hotels talk about the success of their direct booking programs, I know we've talked about this before but kind of curious what you're seeing now in terms of whether or not that's having any impact.



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

Sure. So with respect to sales and marketing, particularly direct sales and marketing, advertising, a lot of the trends that you're seeing with us, and particularly the trends in Q4, were driven by spend at HomeAway, which is ramping up their spend as well as trivago. I think trivago spoke about the declines that they had seen in ROAS. In Brand Expedia, for example, in Hotels.com, we actually saw very nice trends with sales and marketing efficiencies, and sales and marketing as a percentage of revenue was broadly consistent. They were growing at similar rates, which was a nice trend. The way that we think about it going forward is similar to the way that we think -- thought about it in the past, which is generally, what we have observed is that the declines in sales and marketing efficiency from an optical perspective have generally been driven by mix shift for us, which is spending more in international markets, which are generally less efficient, and then building up more efficiency over time. And even though those trends are generally good and going in the right direction, international markets growing faster than the U.S. just leaves a mix shift that puts pressure on the line item.

What we're doing in terms of investing more aggressively in our supply, in our localized consumer experiences, in international markets is squarely aimed at trying to get to better sales and marketing efficiency faster in those markets, and that's the level we're looking at it at. We're looking at it at the individual market level. We're looking at it at the individual channel level. And so far, I mean, based on our experience in this business, we've been in the situation where it has not been a case where we had to pay more for the same. We've been generally able to offset CPC increases and rising cost with better conversion rates through just our test-and-learn velocity and adding better supply.

In terms of the hotels' direct booking campaigns, again, we still do not see an impact on our business, and we look at this in a million different ways. Generally, what's happened in the marketplace is that we have seen a trend towards -- mixing towards more independent hotels as our sort order does take into account the competitiveness of pricing. And as a reminder, generally, our customers are pretty darn brand agnostic. So less than 0.5% of shoppers on Hotels.com are looking for the largest brand by name. And as a result, they're picking the hotels that they see. And I think that they're picking the hotels that are drifting down the sort order a little bit less. So perhaps it's working out for the hotel chains. It seems to work out fine for us, and maybe we've hit a new equilibrium.

Operator

Next from RBC Capital Markets is Mark Mahaney.

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

Great. If I could throw out a couple. When you talk about building out the OTA lodging supply, the particular geographies that you -- that are targeted by you, particularly in 2018 places, that you want to, more than others, build out that supply. And then secondly, as you brought more and more HomeAway inventory real-time booking onto -- into the Expedia platform, have you noticed an overall impact on conversion? Is it too early to tell? But are you -- is it -- are you -- is that allowing you to increase match rates? Or -- and I assume that's what you'd like to see happen in the future. Is there already evidence that that's going to happen?

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

Yes, you're welcome. So in terms of geographic focus, I don't want to get into specifics. I would say that, obviously, Europe is an interesting place for us. Asia is interesting. But of course, we're going to replicate this around the world. So to some extent, what we do in 2018 is just a precursor to what we're going to continue to do on a go-forward basis. But those are a couple of regions that are interesting to us for 2018.

In terms of HomeAway inventory on the Expedia platform, yes, I mean, generally, what we see is when we are able to expand inventory, the overall conversion rates for the destinations generally go up. And that's what we see with alternative accommodations, generally. It can have a higher impact in some markets that have a higher mix of that type of inventory, but we have not yet cracked the code on getting to the degree of proficiency that we want to get to in terms of just matching the perfect property with the perfect shopper yet, but that's exactly the work that we're doing. So



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it is conversion-accretive. We think it can be a lot more, and we are actively working on product features and sort algorithms to actually optimize the opportunity ahead of us.

Operator

Next, we'll hear from Eric Sheridan with UBS.

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

Guys, in prior quarters, you had called out some differences you've seen in sort of core global Expedia growth brands versus things that might have weighed down the growth rate in prior periods, specific brands that you've acquired or have underperformed. Any differences you're calling out for this quarter in terms of brands that either outperformed or underperformed expectations? And maybe a second question with respect to geography. Same thing. Anything to call out in terms of things you saw on the plus or minus side on a geography basis in the quarter that are informing your view for early '18?

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

Eric, thanks. This is Alan. In terms of the kind of the split by brands, the global -- what we kind of refer to as the global growth brands, which as a reminder are Brand Expedia, Hotels.com, Expedia Affiliate Network and Egencia, grew at 17% year-over-year in the quarter. That has been pretty consistent all year long. They grew 19% for the full year. So we've seen good growth there in the high teens. They make up, call it, 85% to 90% of the mix. So we've got a good, good vast majority of our businesses and our hotel business growing in the high teens.

The regional brands, which are Orbitz, Travelocity, Wotif, Hotwire, those types of brands, think of them as being kind of flattish. Sometimes better, sometimes worse. And they're making up, call it, mid-single-digit percentage of the mix. And then all of the other room nights have been a headwind for us. That has essentially eased as we've kind of cleaned the comps on Orbitz for Business and Orbitz Partner Network, where we had churned off components of the business.

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

And then in terms of geographic, generally, a continuation of the usual broader trends, which is international growth is faster than domestic growth. Europe has generally started to be a bright spot for us; particular strength in Greece and Turkey, which had gone through some tough times, and they are back to full strength; Brazil was strong for us; Japan continues to be strong for us; Vietnam, where we're starting to build a presence. So a lot of positive stories. On the downside, Caribbean was -- continued to be a tough spot for us, obviously, because of the storms. But encouragingly, actually, with some of the harder-hit areas, we are actually seeing them bounce back. And we did see them bounce back towards -- into December period.

Operator

Next question will come from SunTrust. We'll hear from Naved Khan.

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

Yes. Just a couple of questions. So a little more clarification on the guidance. If I look at the range, are there any big variables to call out that might cause you to come in towards the low end versus the high end? And then I had a follow-up.



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

Well, I think -- look, the guidance that we put together and the range that we put together is obviously an amalgamation of all the potential outcomes of the various businesses. I think for the most part, setting aside exogenous factors that we would be unaware of at this point, I think we think of it largely as execution. And the teams are out pushing hard to grow the business as well as they can. I will remind you that the investments that we're making, the cloud investment, for example, is, call it, \$75 million more in 2018 than 2017. The investment we're making in the supply acquisition is substantial. If you take those 2 together, that's a mid to high single-digit percentage impact on our guidance. And so if you wanted to "normalize" for that, it would put the guidance well into the mid teens.

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

Okay. And just to sort of get a little more color on this. So trivago just reported yesterday -- I mean, obviously, I'm thinking you consolidated the results. And I guess the guide was probably a little bit worse versus expectations back in the third quarter. So how much of that is kind of being reflected in your guidance today versus where it was at the end of the third quarter?

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

Yes. I mean, I don't want to get into specifics brand by brand, but we are expecting a negative contribution from trivago in 2018 on the profit line.

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

So obviously, that could be an upside. It could be a little bit of downside there perhaps, but it's not where we've got them. For our full year 2018, I don't expect it to be a material mover. Other things that I'd probably call out is foreign exchange which has been pretty volatile of late. Alan, I think you've called that out. And then I would just remind you, too, that we are still finding our way in terms of the booked to stay lag. I mentioned it. Alan mentioned it at HomeAway. And so there is a risk there for HomeAway that as we continue to ramp up spend in performance marketing channels, that we continue to slip revenue out into 2019. But all of those things are forecasted to the best of our ability right now. They're just things that could move things around. Ultimately, the result within the range.

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

Okay. That's perfect. And then on HomeAway, I actually had a two-part question. So I think Mark, you talked about focusing more on brand and performance advertising for HomeAway this year. If you had to think of the spread between the 2, would you be more focused on brand versus performance? And then how would you sort of go about addressing the bookings that are happening off-platform? How would you get attribution for that?

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

Yes. So in terms of brand and performance, yes, I don't want to get into specific mix. I would say that HomeAway has been brand advertising for a while, performance marketing though is one of those things and that's relatively new. So in terms of growth rates, I would expect performance marketing to be a bigger part of the story.

In terms of off-platform bookings, how to get attribution. I mean, the biggest thing that the HomeAway team is focused on right now is just creating reasons for people to book on platform. They've developed some incredible technology around their marketplace feeds, the revenue management platform that they've rolled out, lots of great reasons for property owners and managers to actually use the platform, engage with the platform. When they do get bookings on the platform, they get credit in sort order. And then on the traveler side again, just the Book with Confidence Guarantee, the insurance, the making sure that, ultimately, you're protected from fraud. I mean, they're all great reasons to be on the platform.



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And that's the primary focus for them right now. And in addition, they're looking for areas where there is abuse going on and trying to close those loopholes where they can.

Operator

(Operator Instructions) Next, we have Peter Stabler with Wells Fargo Securities.

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

A couple, if I could. Alan, could you give us a bit more color on the revenue per room night trends you're seeing and maybe how we should think about that going forward? And then secondly, domestic revenue, up 4% in the quarter, up 10% for the full year. How should we think about that deceleration? A bit more pronounced than we expected.

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

Yes. So on the revenue per room night, I mean, it's the usual culprits in there. We've got an impact from just our contracted margins. We've got an impact from the loyalty programs. I would say the last couple of quarters, we've had a little bit more of a negative impact from refunds that we use typically to accommodate customers in times of tough weather. And so that has been a little bit more than we would normally see. I think that the other factor for Q4 is that we had a particularly tough comp. If you look back at what we said in Q4, and actually in Q1 as well of this year, the revenue per room night trend was better than we had anticipated in those quarters, and that was on some packaged pricing trends and related. And so that's a particularly tough comp. We do expect to see the overall trend be favorable in terms of the gap between revenue per room night and ADRs as we continue to move through 2018.

And then as far as the revenue trends, I would say, just if you're kind of thinking about the growth we saw in Q3, which was around 15%, and the growth we saw in Q4, was about 11% total revenue growth, the differences there were the HomeAway deceleration and HomeAway revenue, which I talked about, the variation you saw in the hotel business, both in terms of slightly slower stayed room night growth and a slightly larger impact from revenue per room night. And lastly, just the trivago top line trends also contributed. Those were really the key factors that changed the revenue growth from last quarter.

Mark D. Okerstrom - Expedia, Inc. - President & CEO

Yes. And Peter, on the domestic side specifically, the HomeAway subscription revenue peeling off was one of the largest factors for domestic, so it hit that disproportionately hard. If you remember, last Q4, we were in the spot, and I think we called it out, that we were essentially double earning. We're in the spot we're still recognizing the revenue from the subscription business, including tiers. And we have added the traveler fee and we're comping over that for HomeAway, so that was a bit of a drag.

Operator

Next, Paul Bieber with Credit Suisse.

Paul Judd Bieber - Cr dit Suisse AG, Research Division - Director

Two questions. First, Google announced a few big changes to its flight and hotel search experience. I was just wondering. How would you characterize those changes? And are they more of the same from Google? Or will these changes have a more significant impact on the industry? And then just secondly, just following up on the room night growth decel sequentially, what are the factors that drove the deceleration given that 3Q had the negative hurricane impact? Is that all being driven by the regional brands?



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

Thanks, Paul. I'd say for the Google changes, largely, it's more of the same. They continue to try to create a better and better search experience. They continue to try to monetize more of the page. These continue to be along that same vein. It continues to be a great channel for us, particularly on the hotel side. We get great traffic from them. And we turn those users into repeat loyal customers. But I think, listen, over the long term, we have got to be mindful, and we always are mindful of the incredible market power that Google has. And it just underscores the importance of to make sure -- importance for us to make sure that we build out incredible products, products where we've got the breadth of hotel inventory that spans the whole market. That's exactly what we're doing, making sure that we've got user experiences that are localized and can get people through the booking path as quick as possible. And then importantly, if things go wrong or plans change, it's us. It's us that can help them, and that's where we're uniquely positioned to really add value and to differentiate ourselves from search partners and actually create real customer loyalty. Room night growth, you want to take that?

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

Yes. Listen, on the hotel side of the business, no major story. I kind of walked through the general trends there. We're still seeing very good growth for the global growth brands. We are seeing flattish trends on the regional brands, and we've cleaned the comp on some of the other Orbitz businesses that we had acquired that shed a fair amount of business. There's puts and takes in there each quarter as you would imagine, but no big change quarter-to-quarter.

On HomeAway, we did see slower room night growth in Q4 on a stayed basis than Q3. I think that's largely driven frankly by just the seasonality of that business. It's hyper-seasonal. So much of what's happening there is coming in the third quarter, with that being the busiest stayed season for them. And so that really was the contributor. In terms of the hurricane impact, I mean, we're not sizing it for room nights. We do think it was net-net, about a, call it, in the range of a \$10 million headwind on EBITDA in Q4, on top of what we saw in Q3. So it was a headwind for us in Q4, but we knew about that coming into the quarter.

Operator

Next question will come from Lloyd Walmsley with Deutsche Bank.

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

Two, if I can. First, just on match-back recent interview, Jeff Hurst from HomeAway. I quoted him as saying, "HomeAway had originally expected some of the offline leakage would close on its own, but it hasn't." So I guess just wondering if you could give us your latest thinking on whether you can migrate that \$15 billion of total bookings at HomeAway online? And is that -- why do something like match-back? It's so upsetting to suppliers given the market still seems fairly nascent. And then second one on the shopping cart. I think this first came up, at Phocuswright in November '16. So it seems like something you guys have been working on and testing for a while. Anything you can share with us around how this is impacting conversion rates, transaction values and how you might be able to leverage this as a competitive advantage going forward?

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

Thanks, Lloyd. Listen, on match-back, I think, as is often the case, when you make some of these platform changes, people find ways around them. And we had a situation with a very small group who was able to essentially get credit for bookings as if they were on platform, but actually go around the platform. And so what this program is meant to do is actually, through the honor system, self-report and actually get credit. There will be a vocal minority of people who are against it. But unfortunately, we've got to do these things to drive the health of the overall marketplace. And this particular program doesn't at all change our view on migrating the bookings online. They're making exceptional progress there. It's not just one thing. It's one thing after another thing. And then of course, you find situations like this where people try to find a loophole and exploit it, and you close them down. But we're making great progress there.



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In terms of shopping cart, it hasn't really been live with live traffic for all that long. This is relatively new. Right now, we're live in flight and car. It is -- looks particularly good in mobile. And the implementation is essentially a slide-open tray, if you will, that, as you're shopping, you can press the plus sign and drop things into this tray. And then when you pull the tray over, it's automatically calculating the savings. So we're finding some very encouraging results in terms of what it's doing in terms of attach rates and bundling, but it's still early yet. And of course, it's still just flight and car. We think the big upside comes in hotel, and that will come here, probably later this quarter, we'll start testing it. If not, the second quarter. But it really is a very encouraging product, and it's something we've been talking about doing for many years. And it's great to see it finally in reality and out in the wild.

Operator

Next, we have Perry Gold with MoffettNathanson.

Perry Scott Gold - *MoffettNathanson LLC - Analyst*

With the recent management shakeup at Airbnb and the delay of its IPO until at least 2019, do you see opportunity to lean in even more aggressively to the alternative accommodations sphere to drive faster supply and demand growth?

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

Well, Perry, that doesn't really change our overall philosophy. I think, as we've said a number of times, this is just a massive market. And we think ourselves and other competitors in the marketplace can grow very well for a long period of time. I think these management changes, they happen. You never know exactly why they happen. We've got a ton of respect for the Airbnb team. I think I've met Laurence a number of times. I think he's a very sharp guy. I think people went their own ways. And who knows the reasons, but I'm not reading a lot into it.

Operator

All right. And next from Jefferies, we have Brent Hill. Brent Thill, excuse me.

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Just back to the expenses, sales and marketing outpacing revenue. I know you're not giving detailed guidance, but in terms of the duration of how long you expect that to continue, and I just wanted to be clear on the cloud migration, I think that you expected through '18, you would be through kind of the bulk of that, and the benefit would be more felt in '19. Just sort of hopeful, if you could clarify a little more around both topics.

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

Yes Brent, sorry. Can you just elaborate on your question on selling and marketing? What are you asking we'll -- just direction on...

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Alan, to your comment about sales and marketing outpacing the revenue, how long you anticipate that investment in sales to continue to outpace at that clip.



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

Yes. Well, so we don't have a target for kind of trying to get leverage on selling and marketing. I think it's well-known, the opportunity in front of us. It's well-known that it's a global opportunity. When we launch in a new market, for example, we're starting from scratch in the way in the sense that we don't have repeat customers. We don't have brand recognition in those countries. And so we have to make investments to get traffic in the store, to please those customers to getting -- get them coming back to us. And over time, the goal, obviously, is to build a repeat customer base so that, that particular point-of-sale can start to see at least better overall efficiencies, if not leverage.

From a directional perspective, a lot -- just directionally, we're -- we get more deleveraged today from brands like HomeAway and trivago than we do from the -- some of the Core OTA brands. So just -- I don't want to get into the details of that, but more of it is coming from those brands than the other way around. So for now, we're fine with revenue -- sorry, with selling and marketing growing faster than revenue. And we'll see how the business plays out over the next several years.

On cloud migration, the -- one of the biggest keys for us in 2018 is getting our lodging stack onto the cloud. We're planning to do that in the not-too-distant future. And it's a key milestone for us in terms of how we're doing on that migration, how the performance goes and what kind of momentum we think that would mean for the rest of the year. There will still be work to be done in 2019. I'm not ready to size it today, mostly because we have to see how we do in 2018. But we will start to -- we will have additional migration to do in '19.

From a benefit perspective, we've already seen some. The first thing that we saw early was that we avoided the need to build out another data center. We were getting pretty close to the point where that was going to be a requirement to deal with the size of our business, and that has been completely avoided and completely off the table. We also are seeing a significant drop in CapEx related to data center. Two years ago, our CapEx on data center assets was in the neighborhood of, call it, \$180 million. And that's down to, call it, \$50 million now on an annual basis. So we already are seeing a big benefit in the CapEx side, and that's just on the pure kind of cloud versus data center equation. There's a whole bunch of other benefits that will come from being in the cloud that we think will accrue to us after we're migrated.

Operator

Next question will come from Mark May with Citi.

Mark Alan May - *Citigroup Inc, Research Division - Director and Senior Analyst*

First, on the guidance, the 6% to 11%. If I look at some of the estimates out there in trivago and I back those out, it's -- it would actually be like a 2 percentage point headwind on your guidance. I'm just trying to square that with your comment earlier that it's not really a material driver. Would you say it's at least over a percentage point impact. It just seems like it could be more material. And does your guidance include FX? And if so, what would the 6% to 11% be if it didn't? And then in terms of HomeAway revenue in Q4, it's -- with the subscription rolling off and some other noise in that number, is that a closer look at what organic growth looks like? Can you help us kind of think about -- when we clean that up, is that a clean look at kind of what organic now looks like?

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

So Mark, just on the trivago. My comment was related to the year-on-year growth of Expedia, Inc. So in the context of just over \$1.7 billion of adjusted EBITDA, trivago was irrelevant in 2017. And based upon where they are guiding 2018, we think it will be similarly irrelevant. So that's the headwind.

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

It is a headwind. But it is a headwind.

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Yes. And then in terms of FX, yes. I mean, what we do with our guidance and our forecast is we include current foreign exchange rates. And so to the extent that the dollar weakens after we've done our forecast, that's a tailwind. If the dollar strengthens, that's a headwind. And so that's in there. We don't size it as precisely as you're asking for. The one thing I will remind you, though, is we are a global company. We have people all over the world. We have a reasonably sized natural hedge of folks sitting in the U.K., folks sitting in Europe, folks sitting in Asia. So there is some offset from what you would think would be the -- just the pure impact on revenue translation.

On Away, on HomeAway revenue growth and whether this is kind of what organic growth looks like, I -- no, I don't think the 16% growth that the company posted in Q4 is a typical what we would expect from organic. And the reason for that is that, a, there is a seasonal component, as I mentioned before, so they get a lot more of their revenue in Q3. And they're investing marketing to get that, and so they see outsized growth then. But the other bit is we will eventually reach a subscription equilibrium. We're not there yet. It continues to decline. And so once that gets completely normalized, then we would be into a more kind of, as you called it, organic growth rate.

The last thing I'll mention is that in Q4, they had a particularly tough comp on their service fees. So if you remember back to 2016, when they first started implementing consumer service fees, they did the U.S. in the spring. They did Europe in late spring, early summer. And there's a lag between when they implemented those in the book to stay. And so you can think of Q4 '16 as being the first quarter where pretty much all of the bookings had a consumer service fee against it, and so they comped over that in Q4 this year. Those are all the factors to consider.

Operator

Next question from JPMorgan, we have Douglas Anmuth.

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

I just wanted to go back to the supply acquisition efforts and the step function change that you mentioned. Just trying to understand, I guess, the shift in strategy. I think historically, you kind of had a more measured approach on adding supply, particularly as you sought to balance traveler demand with existing properties, kind of with the new ones coming on board. So if you could talk about that. And then secondly, I think it was '16, the last time you kind of gave a view on margins 2 years out. I'm just curious if you have anything to update there or thoughts as you're looking over the next 2 years.

Mark D. Okerstrom - Expedia, Inc. - President & CEO

Thanks, Doug. It is certainly a shift in strategy from what we've been doing for the last 5 years, but it's a shift in strategy that has been enabled by the hard work we've done in the last 5 years. Really, to get into this position, we had to build global online marketing capabilities. We had to build global multilanguage, multicurrency websites, Brand Expedia and Hotels.com, which we've now done. We had to roll out an agency hotel product, and we did that with our Expedia Traveler Preference program. We had to get our base-level margins to the right spot. And then we had to get into a situation where we can actually wire everything up together so that when we signed up a new property, we could actually start marketing that property in variable marketing channels.

You saw us ramp up our supply capabilities over the course of the last 5 years, from 15,000 to 20,000 a year to this year, call it, 90,000. And next year, we'll do 2x or more of that number. And it's really on the back of us having the capability to do it. We have demonstrated, over the years, to ourselves, and I think to investors, just how powerful it is when you can add supply. You can create better conversion. You can tap into new sources of demand. And so we're absolutely convinced this is the right strategy. Is it a shift? It is a shift, but it's really based on the hard work that we've done over the course of the last 5 years. And then I would give Alan the margin question. Alan, do you want to take that one?



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

Yes. So yes, we did give some view on the -- target P&L on our Analyst Day a couple of years ago. We have not updated those since then. I don't think it would be appropriate to kind of give guidance on that or even directional indicators. We're focused on executing in 2018. We have these key investments that we've talked about that we're focused on. And seeing how this year plays out, just how successful we can be with these initiatives, will play into how we think about 2019 performance and beyond.

Operator

Ladies and gentlemen, we are out of time for questions. I'd like to turn the floor back to Mark Okerstrom for any additional or closing remarks.

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

Great. Well, I'd just like to thank everyone for joining the call and your continued interest in Expedia. Especially, I'd just love to thank our employees for their incredibly hard work in 2017. And thank you all, every one of you globally for -- in advance, for the hard work in 2018. We've got ambitious goals, and we are incredibly excited to get going with them. Thank you very much.

Operator

And ladies and gentlemen, that does conclude today's conference. Thank you for joining us. You may now disconnect.

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