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EXPE - Expedia Group Inc at Barclays Global Technology, Media and Telecommunications Conference

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## CORPORATE PARTICIPANTS

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

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

## PRESENTATION

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

Great. We're going to get started. Good morning, everyone. My name is Deepak Mathivanan, I cover online travel and SMID-cap Internet here at Barclays. We're super psyched to have Alan Pickerill, CFO of Expedia, join us today. There's a lot of topics to cover today. So I have a list of questions to go through. And then we'll have some time at the end for audience as well. So Alan, thanks for joining us.

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

Thank you. Thanks for saying you're super psyched. I think that's probably the best intro I've had at an investor event.

## QUESTIONS AND ANSWERS

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

We really are super psyched. All right, let's start with a big picture question. So there's a view out there that says that leisure online travel market has reached saturation. Do you concur with that view? Is it -- if you think about players like Expedia, going forward, is the growth going to be determined by market share gains versus market growth?

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

Yes, I don't think we would use the term saturation at all. There's several different ways you can cut this, but the first and kind of cleanest is that the global travel market is about \$1.6 trillion. We're at about, I think, \$97 billion, \$98 billion of gross bookings on a trailing 12-month basis through September, so call it roughly 6% of the global market. We're still overindexed to the U.S. So plenty of opportunity to continue to grow on a global basis. Other ways you can kind of look at it is just in terms of our hotel supply. There are literally hundreds of thousands of hotels and vacation rentals around the world that are not yet listed on our sites. People are staying in those hotels and to the extent that we can kind of wire up all of that inventory, plenty of opportunity there. The offline to online, it can be debated. The Phocuswright estimates put it at about call it 50% penetration so far on a global basis. And so we think there's still a tailwind from just travel dollars that are being spent offline and moving online. So we think there's still plenty of room for healthy growth over a long period of time. Exactly what that rate of growth is, it's hard to predict, but we think there's a good runway for getting healthy results.

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

Got it. Okay. And then on the second topic, related to a similar theme, we're now 10 years postrecession and the environment has been pretty strong, demand has been pretty strong on the consumer side. But recently, we are hearing some grumbings that the market is starting to level off. Should we be concerned about a slowdown in travel demand during 2019? What are your expectations?

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

Well, I want to be careful not to comment on 2019 at least in terms of things that would impact or sound like guidance for us because we haven't laid any of that out. I think the main bit of rhetoric that you're hearing and have heard a lot in the last couple of months has been around the lodging cycle itself. You're right to point out that it's been up into the right ever since we climbed out of the recession in 2009. And so occupancy -- especially in the U.S., occupancy is going up and ADR is going up. And so there is a question there about where are we in that cycle and are we still -- is there still room for that to move up? Or is it kind of teetering around the top. As far as kind of what we've heard from hoteliers is there was some indication that their Q3 RevPAR was a little bit lighter than people had anticipated. If you look at some of the subsequent commentary from the hoteliers themselves as well as from Smith Travel Research, which is an industry player, it's looking like and sounding like that was a little bit more of a September issue with October coming back, I think, a bit. And the guidance, at least from the hotel companies, for 2019, I don't think came down substantially. All of the other indicators, whether you're looking at like the number of people traveling on airlines or the growth in airline tickets continued to be positive. So I don't think anything has changed that substantially. The one thing I would point out too, though, is in the lodging cycle, we have some componentry of our business that I would argue is countercyclical. So one example that I would give you is that in a situation where the hotels are finding a softer environment, if we got to that and maybe we're having a harder time filling up their hotels: a, it could provide an environment where they're just more interested in participating aggressively in our properties to distribute hotel rooms. We have a product called Accelerator, which we've had out for, I want to say, about 4 years now, which for those that haven't heard of it is a little bit of a bid for placement tool. So a hotel who's listed on our site can participate in this dynamic tool and can bid up a little bit in terms of how much they're willing to pay for the distribution in order to move up a bit in the search rankings. And that product itself has never been tested in a downcycle or a soft cycle for the hoteliers. So that is one area where it'd be interesting to see the behavior of hotels if things were a little bit softer.

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

Got it. Another key theme over the past 12 months is on the marketing side. You saw good ROI gains based on your optimization efforts. But now if you think about the industry dynamics, bookings 4Q guidance implies some performance advertising deleverage. What is going to be Expedia's approach? Do you think there will be competition once again in the marketing channels? How should we expect that to play out?

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

Yes. I would probably separate it into 2 components. One is that, and for those that are maybe not quite as up to speed, there's been an environment, call it, for at least the last year, where key players in the online travel market have made it known that they want to make sure they're being as efficient as possible in their spend, that they are driving as much direct traffic as they can. For our part, Expedia has been focused principally on testing our marketing spend and determining where we can -- where we might be spending marketing dollars on growth that is not actually incremental. And so a good example of that would be, you can have an opportunity with one of the ad platforms to retarget customers who have been on your site but didn't book with you. And then, so you retarget them. You show those ads coming up in different places and then eventually maybe they click back through and book a room. And in certain cases, we've been able to determine that yes, that customer did come back through that retarget ad and we did pay for it. But if we have not shown them that retarget ad, they were likely to have come back anyway through a direct type-in or an e-mail link or something like that. So that's one area where we're really focused on pulling some of that spend back. The other bit is just at the really, really inefficient part of the curve, we're looking for opportunities to say, okay, here's some spend that's not efficient. Is it just, what I like to call, empty calories? Is this the cotton candy of the online travel industry where, yes, the unit's out there to be had but it's expensive and maybe not profitable and not likely to become a repeat customer. And kind of a unit for the sake of a unit. And in those cases, we are also looking for opportunities to pull some of that spend. And so that's resulted -- and you've seen that in the last couple of quarters in our results where our selling and -- our direct selling and marketing growing much slower than our units and our revenue. I've been clear for us that I think when we kind of get through the majority of that effort, we'll normalize and then without guiding on specifics, I would just say we would expect selling and -- direct selling and marketing growth to return to more normalized trends relative to revenue growth. And I think you're seeing that in the industry as well. I mean, some of the commentary out of Booking Holdings last quarter was around lapping efforts that they had. I kind of separate all of that out as something the industry is going through and companies are looking at and trying to make sure they're optimized. The dynamics in each channel, though, I don't think have changed dramatically. And what I mean by that is we, and I believe other key competitors, on an ongoing basis look at each channel, we look at it by brand, we look at it by geography and we analyze like, what's happening in that channel? Are we gaining share in that channel? Are we losing share? Are we able to hold efficiencies? Do we need to tweak them up or tweak them down? And we look at



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what we think our competitors are doing in that channel as well, and that does play a role in what we do. But that has been the case throughout this entire exercise and I think will continue to be case as we move forward.

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

Got it. Okay, that's helpful. A question on the OTA side before we talk about HomeAway. So supply acquisition in the international markets has been a key initiative over the past few quarters. We've seen supply ramp. What else is going on in these markets? When should we start to see meaningful market share gains significantly in these areas?

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

Yes. So just to level set everybody. Our long-term goal hasn't changed. Our long-term goal is to build out a great global business, and there are key markets all around the world where we have subscale businesses that we think eventually could be big, full online travel businesses with lots of good brand recognition and direct traffic and repeat customers. Historically, the way we kind of got after that was to kind of focus on all of those countries at the same time and put a little investment here, a little here, a little here, a little here, and just kind of improve a little bit across all of them. And what we've done, and the big change for us in the last year, was really to say maybe it would be a better approach to say let's pick a handful of those markets, let's do a real good analysis of what the gap is, what supply are we missing, what local content are we missing, is there a translation? Are there localization? Are there local payment methods that we're missing? And let's try and close that out as quickly as we can, focus on those handful of markets with the idea that once you get that work done, you could start to see obviously better room night growth. Eventually, you would start to see repeat traffic. Because if you don't have a whole product, you don't actually deserve to have the repeat traffic. If somebody comes in and the experience is kind of half there, maybe just doesn't have all of the inventory you'd expect to see or it doesn't have a key payment method, then as a consumer you're looking at that and saying, okay, well that's not really a full product. And so maybe the next time I search for travel, I'll just start on Google again. And so that's the change in our approach. We have seen good results there so far. It's very early in that process. We just hired up all the market managers in the first quarter. We've been adding properties at a rapid clip. We can see some early signs of progress on the room night growth but the real benefit will come over time. And then the real benefit, if it works the way we think it will work, is taking that handful of markets, piling on another handful of markets doing the same thing, piling on another handful of markets and getting kind of the really good international growth flywheel going of full, complete products that please customers, that have everything they would want and drive that direct traffic. Because the thing about this business is that if you're -- you tend to -- when you launch these businesses in new markets or you try to grow these new markets, you tend to prospect all of your customers off performance-based marketing channels. And that's -- those are high-cost channels and so your relative marketing efficiency is not kind of where you think it will be eventually. And the money to be made is really about having a great product, so that as a consumer I say, yes, this is where I shop for travel and instead of starting on Google, I start on Expedia.com or Hotels.com.

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

Got it. Okay. Switching gears to HomeAway. Bookings growth decelerated a little bit in 3Q, and I know there's a lot of online moving pieces. Can you explain them a little bit in detail?

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

Yes, so we've tried to climb through this on our Q3 call. I'm happy to kind of walk back through it. Essentially, the bookings growth that HomeAway posted in Q3 was essentially in line with what we expected for the quarter. The factors there are a few. One is that they have spent the last 3 years transitioning from a listings business to a true travel e-commerce player. And as they've done that, there has been all kinds of efforts to move parts of an existing book of business from offline to online. And that has provided a very interesting and effective tailwind for their growth in the 3 years since we've owned them. Additionally, they built up a performance-based marketing team and the tools and technologies required to be good in true performance-based marketing, and they're lapping over some of the early efforts there. And so that just makes that growth a little bit harder to come by. There were some smaller components we mentioned on the call: international bookings growth, for example, was impacted by the



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fact that we had rolled out some specific things in the comparable quarter a year ago that really moved some bookings online and they were comping over that. We also have been, over time, consolidating some of the brands because, for those that don't know, HomeAway actually had a whole bunch of international brands -- very international brands onto the platform. And often when you move -- we've seen this in our OTA business as well, when you move from one platform to another, you can have a little disruption in the progress while you optimize the new sites and get the customers used to the new sites. So those were some factors that played into that as well. We haven't guided on a long-term growth rate for HomeAway, but I think that we think that, a, the category is gigantic and growing; b, we have been over indexed to principally just to -- secondary homes -- second homes in pure vacation destinations. We haven't really done anything in urban markets in the U.S. for example yet. The HomeAway business skews more U.S. than I think any of our other businesses. And so the international growth opportunity for HomeAway is immense as well. So again, I don't know exactly where -- what a normalized growth rate is for the top line for HomeAway, but I'm pretty confident that if we execute well, it should be good, healthy growth over a long period of time.

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

Got it. Elaborate on the supply side a little bit. I mean historically, it's been very traditional vacation rental homes and you talked about the opportunity on the urban homes. What do you need to do from a product standpoint and maybe also from go-to-market standpoint to scale up that inventory and then drive transactions on those?

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

Yes. There's a couple of things. I mean, one is, the team -- because of the transition that we were going through, the team had not really been overly focused on supply acquisition anyway in the 3 years since we've owned them. Supply has grown nicely in spite of the fact that they have not been overly focused on it and it is an industry and a category where it can grow somewhat virally. And so we've seen I think supply growth in the 20% range year-over-year for HomeAway in spite of the fact that there wasn't a ton of focus on it. For urban, we had a couple of acquisitions recently, one was called ApartmentJet and one is called Pillow. I won't go into a tremendous amount of detail but these are basically technologies that allow multi-family buildings in urban markets to get a handle on and understand and better monetize online bookings. And so that's one example of some effort that we're undertaking there. But there will be additional focus and some investment required to grow the supply globally.

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

Got it. Last question on HomeAway. You talked about the -- team buildout on the marketing side and then also the potential investments that went into it. Where are we in that cycle now? Are we at a point where marketing investment is going to grow in line with kind of revenue growth? Or do you think there's opportunities to ramp up marketing spend while also seeing acceptable ROIs?

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

Yes. I don't want to be super specific. I think it's a little bit more of the latter than the former. I think they've made a ton of progress on their performance marketing. But I think just given the global growth opportunity in front of them and where they are in their cycle, there is certainly still opportunity for them to find additional ways to invest performance-based marketing spend in a profitable way. And so we would expect them to do that going forward.

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

Okay. A couple questions on the financial side. So I mean if you think about on the core OTA business, for the past several years, we've seen sort of like the room night growth outpaced EBITDA growth by a few hundred basis points-or-so in terms of organic rates. So looking ahead, if you think about the underlying pieces to it, there's ADR trends and then there's also revenue per room night trends and then obviously the marketing leverage, which is another big piece in that. So what should we expect in terms of drivers? And should we expect a similar cadence in terms of relationship between EBITDA and room night going forward as well?



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

Yes, there's a lot of moving parts in there. I think it's a little hard to kind of just be specific to equating room night growth to EBITDA growth, at least in the way that you've phrased the question, and that's because like our marketing spend is not all purely based on driving room nights. We have marketing, like for Brand Expedia is the best example, where it's -- we're marketing Expedia. Some of those customers are booking room nights, some of those customers are booking cruises. So it's not as pure of an analytic as you might like if you are looking at a pure hotel business. I think, from our perspective, I will just take you back to some of the stuff we've already talked about on selling and marketing. Right now, we have had an outsized benefit, I would argue, in the recent past on these efforts that we're taking in selling and marketing and that's had an impact on our EBITDA growth. And as I said earlier, I would expect that to get back to a more normalized number. And then across the rest of the P&L, we really are -- we are seeking to get leverage out of things like G&A for sure, certain components of cost of sales. We've seen some good leverage there and those efforts will continue. But I would just remind folks that we are not necessarily optimizing for specific rates. So we're not optimizing for a specific room night growth rate. What we're -- and we're not optimizing for a specific EBITDA margin percentage. We're trying to find a balance in our effort to grow the business globally, where we deliver good, healthy top line growth, where we invest in the business over the long term to position it well for the next 10 or 20 years, and where we deliver healthy profits and profit growth. And our focus on EBITDA is principally on dollar -- just dollar growth. And we look at that for EBITDA, we look at it for free cash flow, we look at it for adjusted EPS. And we think if we execute well and we find that right balance, then we'll be able to deliver that.

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

Got it. Okay. And then you're obviously in the middle of a big cloud migration that's expected to be about \$250 million next year in terms of OpEx. Talk about other areas of big investments. I know you haven't guided for 2019 yet, but should we think about 2019 as another investment year as well?

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

Yes. Just to correct you on one thing. We said over \$250 million on the cloud spend in 2019. I would say it's a -- the question is interesting because when you have a business like the business that we have, with the global opportunity that we have and the fact that we think that opportunity provides something that we can get after not just for next year or for 2020, but actually for the next 5, 10, 15, 20 years; when you're going after that, you're going to be investing in components of the business every single year. We're not -- we could pull out of a bunch of international markets and be much more profitable. But that wouldn't be positioning the business well for good long-term growth. So we're not optimizing that way. I think what we've talked about and what we want to be clear on is that we think that we can strike a balance between making those investments that you need to make to build the business over the long term, but also delivering something that investors would like to see in terms of profits and profit growth. For things to think about for 2019 investments, cloud is one. We did talk about getting to another handful of markets that we would call our focus markets but we've also been clear that we think the investment into those new markets is not going to be as great as it was into our first round. And then I would probably also put HomeAway in that category in some sense just because HomeAway is not in the same part of the cycle as some of the rest of our businesses and has a key competitor that's investing very heavily. And so we do want to make sure that we're finding -- we think we can find balance for HomeAway too. But we've got to make sure that we're finding a good balance there so that we are investing appropriately in that business given the opportunity that's in front of it.

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

Got it. We have a few minutes left, any audience questions? Okay, I'll keep going here. So in 2017 -- I mean, in 2018, we saw the EBITDA cadence in terms of quarterly seasonality become more pronounced. So if you think about the business, is that kind of like the right way to think about where it would be for the next few years as well? Meaning that 4Q and 1Q being investment quarters, and then the peak travel season becoming much more profitable?



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

Yes. I mean I think directionally, yes. And the way to think about that is that there's a few key components. One is that in a business like this, you're investing in your marketing spend throughout the year to drive gross bookings throughout the year but the stays for those are disproportionately in Q2 and Q3, principally in Q3, and so that's when you recognize the revenue. And so it creates an environment where your margins are going to be under pressure in -- especially in a growing situation, your margins will be under pressure in Q4 and Q1 and the payoff comes in Q2 and then even more in Q3. And so generally, I think that should be the way you think about it. This has been the case even before we owned HomeAway. It's especially the case with HomeAway because HomeAway's even more seasonal than the rest of the businesses with so many of their stays occurring in Q3 relative to the rest, longer booking windows and things like that. So that is true. In '18, just to be clear, we have some other factors that play, one is that we did scale up some of these investments as we moved through the year. Market management investment is one of the key ones. That's at full scale now in Q4 of '18. And it was not there in Q4 of '17, so it's -- that is a particular pressure on Q4. It's not related to HomeAway, but it is related to kind of the way the investment cycle scaled up.

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

Great. I think we're out of time with that. So we'll stop it right there. Thank you so much, Alan.

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

Thank you. Yes, thank you very much. Thanks, everyone.

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