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EXPE - Q3 2017 Expedia Inc Earnings Call

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Co. reported 3Q17 YoverY revenue growth of 15%.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Expedia, Inc. Q3 2017 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Kristy Nicholas, Head of Investor Relations. Please go ahead, ma'am.

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

Thank you, Cynthia. Good afternoon, and welcome to Expedia, Inc.'s financial results conference call for the third quarter ended September 30, 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 questions, reflects management's views as of today, October 26, 2017, only. We do not undertake any obligation to update or revise this information. As always, some of these 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



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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

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's gross bookings and lodging room nights for clean comparisons.

Finally, 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.

With that, let me turn the call over to Mark.

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

Thanks, Kristy. Firstly, thanks to everyone for joining our call today. I'm thrilled to be at the helm of Expedia, Inc. and incredibly optimistic about the opportunity ahead. Before launching into a more detailed discussion of our Q3 results, I did want to take a few minutes to share some preliminary thoughts about where we are as a company today and how we plan to evolve to better position ourselves to seize the enormous potential ahead of us.

As anyone following the industry knows, the size of our opportunity is huge with the total travel market representing annual spend of around \$1.3 trillion globally. We built this company into one of the largest players, yet we only have mid-single-digit percentage market share, making our potential runway for growth long and wide.

Over the last 6 years, we created exceptional returns for our shareholders, while at the same time designing, investing in and building truly global platforms with the potential to deliver growth in shareholder returns for a long time to come. We built, bought, invested in and integrated some of the best travel brands in the world. We modernized our technology stack, giving us the capability to learn fast and improve customer and partner experiences across desktop and mobile at scale, while at the same time delivering significant operational efficiency gains in areas like payments and customer operations. We restructured our hotel margins globally and rolled out an agency hotel product to ensure that neither margin nor model were barriers to any lodging partner joining our platform and giving us great inventory. We retooled our hotel acquisition machine and developed solid scaling ability, and though we still have much to do, we dramatically improved our global performance marketing capabilities.

It's been an incredible journey, but we believe the next phase can be equally, if not, more exciting. We now find ourselves in the enviable position of having all of the essential assets needed to realize our full potential as a company. Looking forward, we are more optimistic than ever that we can gain share and create significant value over the long term. And while M&A is and will always be in our DNA, when we compare the returns of tomorrow with the returns of yesterday, we expect to disproportionately generate value from solid organic execution.

With that backdrop, looking forward from an operational perspective, we will focus on 3 primary themes, each of which are natural evolutions from where we are today. Firstly, we will refine our ambition of going global to an ambition of becoming locally relevant on a global basis. Going forward, we will not be satisfied with simply expanding our international point-of-sale presence. Instead, our ambition will be to build market-competitive and ideally market-leading offerings in every single market in which we choose.

To deliver on this ambition, in our priority markets, we'll make more aggressive supply, content and translation investments, focused technology and infrastructure initiatives to benefit these markets and ramp up our marketing spend as we improve the quality of our offering. Though the results of this shift in focus will not accrue overnight, our experience tells us that execution on this path is the winning formula.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

Secondly, we will become much more customer-centric, putting the A back into OTA. Over the last 20 years, we put the power of research and booking into the hands of customers around the world. With the digital age, we made researching and booking travel exponentially better, but we still have a long way to go in truly alleviating customer pain points. The passion of our employees combined with the power of machine learning and our incredibly rich datasets make us confident we can do much better on delivering on the agent promise on a go-forward basis.

Finally, we will accelerate the pace of execution within our organization. Working towards total organizational alignment around focused priorities, clear decision-making and deliberate execution rigorously measured, we hold the power to take Expedia from the great company it is today to a different level. In short, we need to focus on what is most important, then do it better and faster.

With the above operational focus areas, we will be in a better position than ever to drive growth across our business on a go-forward basis. As a leadership team, we are all energized about this next chapter. During my 11 years at Expedia, our employees around the world have proven repeatedly that they are capable of nearly anything. I'm extraordinarily excited to lead them and empower them as we all evolve Expedia towards its full potential.

Now let's turn to our Q3 results. Though underlying execution was solid on a number of fronts, our overall results were weaker than expected. Q3 gross bookings grew 11%. Revenue grew a healthy 15%, and adjusted EBITDA grew 6% year-over-year. Stayed room night growth was 16% year-over-year, a bit slower than our first half 2017 growth rate of 17%.

Our results this quarter were negatively impacted by the record storms that hit the Americas beginning in late August and continued through mid-September. Excluding estimated impacts from these natural disasters, adjusted EBITDA would have improved by approximately \$15 million to \$20 million, and our total stayed room nights would have grown largely in line with the first half of 2017.

In our Core OTA segment, we saw continued good momentum. Our global Core OTA brands continued to grow room nights at a healthy pace and collectively delivered room night growth of 18%. For certain of our regional brands, being U.S.-centric made them particularly susceptible to recent storm impacts. Separately, we're pleased to bring our total available Core OTA property counts to more than 500,000, including over 95,000 HomeAway listings available on 28 Brand Expedia, Orbitz, Travelocity, CheapTickets and ebookers points of sale, representing lodging portfolio growth of 57% year-over-year.

Despite storm impacts, Egencia grew gross bookings 9%, and revenue grew 13%. We are pleased to see real progress on our ramping of Egencia's sales force in the quarter, and we're even more pleased in Q3 to see them sign a quarterly record of approximately \$385 million in new client business. We have high ambitions for Egencia to double last year's gross bookings by 2020, and it's great to see them getting some solid traction towards that goal.

Moving on to HomeAway, Q3 marked another solid quarter of execution by the team as they continue to drive their transformation from a subscription business to a true online e-commerce business. For Q3, transactional revenue exceeded 75% of HomeAway's total revenue for the first time ever. Conversion rates at HomeAway continue to steadily climb as they ramp up test-and-learn velocity on traveler-facing experiences and introduce new features, making it easier and more attractive for travelers, property owners and managers to transact on the HomeAway platform. Given solid progress at HomeAway, we plan to lean even more heavily than anticipated earlier this year into paid marketing channels, a trend we expect to continue through 2018.

trivago's revenue growth on a stand-alone basis decelerated to 22% year-over-year, driven by trivago's traffic and marketplace optimization efforts, along with advertisers' ever-changing responses to those efforts, leading to less monetization of the marketplace. We do expect marketplace monetization and advertiser behavior to normalize over time. Regardless, trivago will continue to face very difficult revenue comps through the first half of 2018. Despite these current challenges, we know trivago is one of the best-known and best-loved consumer brands in travel and that trivago remains a very attractive travel advertising platform for OTAs and hotel companies across the globe. As such, we remain convinced that trivago will execute through its current challenges and remain a large and important player in the travel ecosystem for a very long time to come.

In closing, though we are not at all satisfied with our Q3 performance, our sights are clearly aimed at the longer-term opportunity ahead. I am extremely optimistic about what we can achieve with our greater focus on becoming locally relevant globally, becoming much more customer



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

centric and moving much faster as an organization. To that end, going forward, you should expect to see us lean more aggressively than previously contemplated into marketing, technology and supply investments through the remainder of the year and throughout 2018. In doing so, we expect to create yet another phase of delivering tremendous shareholder value.

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

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

Thanks, Mark. Briefly, I'd like to say how honored I am to be in this seat today, to have the chance to partner with you, the rest of the leadership team and Expedia employees globally to continue to build and grow the best and largest travel company in the world.

In spite of the headwinds created by the recent natural disasters, lodging revenue, including both hotel and total HomeAway revenue, increased 15% for the third quarter, driven by stayed room night growth of 16%. In the hotel business, revenue per room night declined 3%, while average daily rates grew approximately 2%, leading to a gap between these 2 metrics of approximately 450 basis points, essentially consistent with last quarter and right in the range of our expectations.

HomeAway gross bookings grew 44%, while revenue grew 45% to \$305 million. Stayed property night growth came in at 36% and would have been higher absent the hurricanes. Third quarter transactional revenue grew by 116% and peaked for the year at \$236 million. Subscription revenue declined, decreasing by 37% year-over-year as HomeAway continued to gain momentum in their e-commerce transition. HomeAway reported the highest quarterly adjusted EBITDA in the company's history of \$126 million, representing 63% growth year-over-year.

Advertising and media revenue of \$299 million was up 24% year-over-year due to continued growth at trivago and Media Solutions. Performance for trivago came in substantially below our expectations as compared to the second quarter call, with adjusted EBITDA for trivago falling to an \$8 million loss on 22% revenue growth. As discussed on trivago's earnings call yesterday, they continue to see negative trends as advertisers adjust to the new normal and test new bidding strategies.

In terms of expenses, cost of revenue grew 8% year-over-year, 4% ex cloud, leveraging quite nicely. Cloud expense in cost of revenue totaled \$17 million during the quarter. For the full year, we continue to expect cost of revenue to grow slower than revenue, including cloud costs.

Total selling and marketing expenses grew 21% year-over-year, driven by a 22% increase in direct expenses. Despite the headwinds created by the natural disasters, we continued to make aggressive marketing investments across our global brands. Additionally, performance at trivago impacted direct marketing expense growth rates. We continue to optimize our regional brands with a bias to our profit versus top line growth.

Technology and content grew 13% year-over-year, primarily driven by a higher headcount along with the addition of SilverRail, and included \$11 million in cloud expenses. Including cloud expenses, we expect technology and content to grow slightly slower than revenue for the full year.

General and administrative expenses grew by 17%, a bit faster than normal on significantly more difficult comps and higher headcount along with the addition of SilverRail. We continue to expect good leverage on general and administrative expenses for the full year.

Our cloud migration project remains on track. We spent a total of \$29 million on cloud during the third quarter compared to \$11 million in the prior year period. Year-to-date, we've spent \$66 million across both cost of revenue and technology and content. We now expect to spend around \$100 million on cloud this year.

Turning to the balance sheet, we opportunistically placed approximately \$1 billion in senior notes with a 2028 maturity and a coupon of 3.8% during the quarter. This represents Expedia's largest-ever bond deal and an excellent source of long-term capital at very attractive interest rates. And to confirm, our long-standing leverage targets and approach to capital deployment have not changed. We will continue to balance share repurchases, our quarterly dividend and opportunistic M&A. Additionally, this quarter, we were pleased to declare a dividend of \$0.30 per share to be paid in the fourth quarter.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

Turning to our financial expectations for full year 2017. On a consolidated basis, including cloud spending, we now expect adjusted EBITDA to grow in the mid- to high single-digit percentage range. Our expectations reflect a meaningfully lower EBITDA contribution from trivago in the fourth quarter and include a hangover effect of the natural disasters we discussed today of nearly \$10 million. In addition, as Mark noted in his opening comments and as we spoke about in our Q2 call, we continue to lean into performance-based marketing channels and are ramping up investments in our hotel market management sales force, both of which put pressure on our bottom line performance near term, but both of which we believe are the right investments for the long term.

Although we've not yet completed our 2018 planning exercise, we did want to give you some initial thoughts and key factors to consider when looking out into 2018. Firstly, as it relates to our Core OTA business, as Mark mentioned, we have gained increased confidence that an accelerated pace of property addition along with related marketing and infrastructure investments in priority markets will produce outsized returns over the medium term. As a result, we are currently in the process of ramping up the required resources. Additionally, we also expect our cloud expenses to ramp significantly in 2018, all of which we expect to put pressure on 2018 profitability.

Secondly, we see great potential at HomeAway given solid progress we have seen in the transition so far. As such, with our eye to the long-term opportunity, we are inclined to continue to invest in that business. Additionally, HomeAway is undertaking its own cloud migration, which we estimate will result in nearly \$30 million of direct cloud expense next year. Given these factors, we now expect HomeAway's 2018 EBITDA to be below the previous target of \$350 million.

Third, trivago performance is currently challenged and as a result, our expectations for trivago for 2018 are significantly lower than they otherwise would have been.

Finally, as a further framework for understanding how we are approaching 2018 from a financial planning perspective, we have an established track record of appropriately balancing long-term investments while delivering near-term results. Against that backdrop, with very few exceptions, we historically delivered adjusted EBITDA growth in the range of 10% to 20%. In years where we believe it appropriate to be more aggressive in our investment efforts, we have generally delivered full year growth closer to the low end of that range. We look forward to giving you more precise 2018 guidance on our Q4 call.

With that, let's turn to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from Lloyd Walmsley with Deutsche Bank.

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

A couple if I can. I guess, just first on HomeAway. Can you kind of give us a sense for whether the fees that we've been seeing on the customer side of late are going to continue at these elevated levels into 2018 or if these are perhaps just tests? And how should we think about, I guess, the mix of subscription -- bookings on subscription listings versus paper booking listings that carry a host fee? Is that something you can give us a little bit of color on in terms of the mix and the trends? And then shifting to the core, can you just talk a little bit more about the investment that you're going to make next year, aside from, obviously, the cloud expense and perhaps a little bit slower growth, that's leading to that EBITDA in the -- towards the low end of that 10% to 20% range?



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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

Sure, Lloyd. Happy to do it. So firstly on HomeAway, it's hard to say with any precision whether, looking forward, fees are going to be at the level that they're at right now. The team is really doing a ton of testing, so you may see something that other consumers don't see. I mean, we will do things where we test things sequentially, so it's hard to get a gauge or give you more guidance than sort of keep your eye on things. In terms of mix between subscription and PPB on the host side of things, I think, generally, the trend has been to shift to more PPB. I -- it's hard to say exactly where it will go. I mean, I think that all the hosts are trying to figure out what's the optimal breakeven point for them. But I think, increasingly, as HomeAway transitions to a real marketplace model and starts introducing things like the Accelerator program, which we've got on the hotel side, I think it may be the case that PPB hosts just have a better ability to compete in that marketplace, but time will tell. But the trend is definitely towards more PPB.

In terms of the investments in the core besides cloud, really, this is all about us being in a position now where we've basically stamped out point-of-sale presence around the world. Hotels.com, I think, is now in 75 different countries around the world. Brand Expedia has a few to add certainly, but they've got a decent presence. So we sort of planted our flags, if you will, for the most part. And now it's about looking at all of those markets which are large attractive opportunities where we're not #1 and figuring out exactly how do we get to #1. And it's not a secret. We know exactly what we need to do. We've got to have great hotel inventory. We've got to have great content. It's got to be translated well. We've got to have landing pages, got to have variable marketing campaigns going. We've got to have, where we've got a very competitive product, compelling television advertising, for example, to tell the world how great it is. So we know what to do, and we're now in a position where we've got these global platforms in place. And it's about more so going deep as opposed to going wide.

It's hard to say right now or give you more color in terms of exactly what the level of investment is, how much we'll return in-year. But what I'll tell you is that the investments that we're going to put in through Q4 and into 2008 (sic) [2018] will represent a step-up, but the returns from those investments accrue over multiple years. And whether we'll have to do step change after step change, I doubt it. I think it's going to be a step-up in investment that we'll grow from. And the goal here ultimately is to build just much more compelling consumer experiences around the world, and more compelling experiences bring better top line growth, bring better marketing efficiencies and ultimately, better EBITDA margins over the long term. And that's the goal here.

Operator

We will go next to Peter Stabler with Wells Fargo Securities.

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

Mark, could you give us a little bit more color around the decision to lean more aggressively into the marketing for both HomeAway and the Core OTA products? Is this reacting to the competitive landscape in the performance marketing channels from a -- across different regions? Or is this more kind of a philosophical shift, now that you're in the seat, on seizing this opportunity? Any color would be appreciated.

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

Sure. It's not really, or in actuality, a result of me changing focus or changing the focus of our various businesses. It's a by-product of a lot of the thinking and execution that the teams have been working on. So for HomeAway, for example, they, by the end of this year, will be in a position where they have a true technology-driven performance marketing platform in place. And with the increase in online bookable properties, they've got now up to 1.5 million with 1/3 of those now being instantly bookable, with the platform in place, they're just going to be in a better position to actually execute on performance marketing, make sure they've got coverage and actually track the results than they've ever been. So that will enable them to step it up.

I think as it relates to the Core OTA business, again, as we ramp up hotel properties, this creates essentially new opportunities for marketing for us, so we'll see associated marketing spend that go along with our ramp-up in property acquisition. And then I would just say that the team has just



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

continued to get better and better and better in terms of just approaching performance marketing really across all of the capabilities, and that gives us confidence to spend more and hopefully, will allow us to spend more ultimately and deliver better returns over the long term. So it's really execution. It's not a strategic shift, and I'm not changing the way that we'll be doing things on performance marketing.

Operator

We will go next to Paul Bieber with Credit Suisse.

Paul Judd Bieber - *Credit Suisse AG, Research Division - Director*

I have 2 of them. What was the bookings impact of the natural disasters? I think I saw an EBITDA impact, but I wasn't sure if you had highlighted a bookings impact. And then also on the increased cloud spend, what does "ramping significantly" mean? Can you just provide some context around that?

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

Yes. Thanks, Paul. This is Alan. Listen, on the bookings side, we didn't quantify it in the prepared remarks. We obviously have looked at it across the entire P&L. I would say the primary factor there has been -- on bookings has been a slowdown in domestic room nights booked in the period from about mid-August into a good part of September. And you can see that in our domestic bookings growth in Q3 compared to Q2. So that's the primary impact on gross bookings. On revenue, it's a combination of canceled room nights and then also refunds, where we're refunding more than we normally would in order to accommodate customers, but we haven't quantified the specific amounts.

As far as the cloud spend is concerned, I'm not prepared to give you a number today. We are certainly in the process, but I guess what I'd like to do is just kind of be sure that everybody understands how this works. The spend that we're talking about is basically the spend that we pay to a cloud provider for compute power. And so as we move more and more of the products, the technology, the functionality into the cloud computing environment, then the spend ramps up. As we move through 2017, we are putting a fair bit of the compute into the cloud, the biggest component of which happens to be our -- components of our lodging stack. But by the end of this year, we will still have significant compute to move into the cloud, and so that will happen into 2018. And all of that results in an increase. So we'll have more details on that in -- when we give the guidance, but it is a meaningful increase. I mean, I would say it's -- think of it as being more than 50% increase year-over-year.

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

Yes. And I would just remind you, too, in addition to moving more compute into the cloud, there is the annualization of the exit rate of compute that's in the cloud as at December. So you're already on a growing base, and then our ambition is to move as much as we can essentially into the cloud. But as a reminder, the real benefit here comes in -- yes, there will be some operating savings in terms of decreased power cost that show up in our cost of sale, largely from running our own data centers, but also a significant reduction in capex. And you've already seen that. You saw it last quarter. You're seeing it again this quarter. That will be a trend going forward. And importantly, it's not only just a year-on-year decrease in capital expenditures from what we have had in the past, but remember, just given the amount of growth that we've been driving, this is also about avoiding the future capex to just fund that growth that we'd have to spend and then throwing maintenance capex on top of that. So we're more convinced than ever that this is an excellent decision from a free cash flow perspective. We're more convinced than ever that this is an excellent decision from a performance standpoint, and we are more convinced than ever then from a velocity of innovation standpoint that this is the right move.

Operator

We will take our next question from Deepak Mathivanan with Barclays.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

Deepak Mathivanan - Barclays PLC, Research Division - Research Analyst

Two questions for me. So first, direct marketing spend delevered by about 200 basis points, but growth rates also decelerated to 21% this quarter. I know trivago is going through pricing changes. But could you discuss whether you saw changes in efficiencies across any of the marketing channels that might have kind of caused the deceleration in room nights stayed? And do you think trivago is now at a point where it kind of makes sense from an ROI standpoint to grow spend again? Or do you think there are still adjustments needed?

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

So yes, so let me start on that, and then Mark can jump in. I think as far as the overall deleverage on selling and marketing, I think more than anything else, the 2 primary impacts are the impact of the storms. You have a situation where your revenue is hit both, as I said earlier, from cancellations as well as from refunds, but the marketing spend carries on, pretty much. So the marketing spend for the stays during the quarter has been spent prior to and into the quarter, and then there's marketing spend that carries on to try to drive gross bookings going forward. So I think that's an element.

I think the second element we talked about is just the fact that we're seeing a disproportionate mix of our volume coming from the higher-cost channels, and so just mathematically in a given quarter, that's going to result in lower net efficiencies.

And then the trivago component, I think you're right to point out, and I guess the main factor there is that as trivago saw changes in their marketplace and a slowdown in their revenue growth, they didn't necessarily pull back their marketing immediately. And so they are also going through the process of determining what their appropriate marketing spend ought to be given kind of what will become a new normal for them on their growth rates. Mark, do you want to add to that one?

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

Yes. Just a few things on trivago because I know that is a story, so I'll just sort of broaden the conversation a little bit. I think, first of all, just from the impact on our results from trivago, in addition to the bottom of our result, obviously, as that channel has slowed down a little bit, it can have a negative impact on the room night growth of our business.

But elevating back up to trivago just generally, I would just say that we continue to believe that this is just an excellent business. trivago has an incredible consumer following because it's an incredible consumer product. The management team is excellent. They are terrific operators. They're getting used to being a public company obviously, but they are just excellent, excellent operators.

And the third thing I'd say is that it is a very attractive marketing channel for OTAs and hoteliers, and that has not changed. What has changed is that trivago has made a number of modifications to their marketplace, and including the introduction of the landing page score and then the normalization of that landing page score. And advertisers are basically testing into that channel to figure out what the best way to get the best volume at the right efficiencies are from that channel, and I think that's going to take a little bit of time. But as that volatility settles out, and we do believe it's going to settle out, we're not at all questioning whether it's going to be an important channel for our OTA brands. We know it is and will always be, and we're not questioning the importance of trivago in this ecosystem at all.

Deepak Mathivanan - Barclays PLC, Research Division - Research Analyst

That's helpful. Mark, just a quick follow-up on that. Was there any other channel during the quarter that might have been disproportionately inefficient with respect to marketing efficiencies?



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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

No, nothing I'd call out. Again, the big movers here are -- and there's probably 3 of them: There is trivago itself not being able to pull back fast enough and deleveraging more than they would like; there is essentially the impact of the storms taking revenue away without taking sales and marketing away; and then there is our Core OTA business and HomeAway starting to ramp up in performance marketing channels, with some associated revenue hitting in the quarter and some coming in future quarters.

Operator

We will go next to Jed Kelly with Oppenheimer.

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

As you talk about more aggressive advertising for HomeAway in 2018, should we expect next year's online bookings to actually accelerate past this year's seasonal trends that we've seen in bookings over the past 2 years? And then can you speak to some of the qualitative drivers around HomeAway's room nights growth lagging online bookings? I guess, some has to do with the hurricane. And should we expect this gap to close or even reverse as you start to drive more shoulder season and urban-type travel?

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

Jed, I'll take the first one, and I'll turn it over to Alan for the second one. Listen, I think, certainly, HomeAway's aspiration would be to accelerate online bookings, but remember that the historic portion of HomeAway's bookings that came from performance marketing channels was pretty darn small. And actually, a lot of it comes direct. A lot of it comes through other branded sources. SEO is a source, and that's been challenged across the whole industry. So the question is does the performance marketing, does that become big enough to move the overall number up or not, and we don't really know the answer to that. I mean, what we do believe, obviously, is that performance marketing-based bookings are going to grow very quickly and will probably accelerate. But whether or not that can move the whole number, it's hard to say at this point.

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

And Jed, I would say on your second question just looking at the room night growth relative to the gross bookings growth. Obviously, over a period of time, they're going to be the same. And the primary factor in the quarter actually probably has less to do than a significant difference in the rate of room nights booked versus room nights stayed and a bit more to do with their ADRs. Their ADRs are up kind of mid- to high single digits year-over-year, as they have been for a while, and that's a combination of mix. It's also impacted by the mix of larger, bigger homes being booked. So I don't think there's a huge story this quarter in terms of their booked volumes versus their stayed volumes.

Operator

We'll go next to Mike Olson with Piper Jaffray.

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

Couple of questions. Other than the hurricanes and the increased investment in various areas that you outlined, would you say there's any weakness in just fundamentals of the travel environment or any market share issues that you're bumping up against?



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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

Well, I'll take that one. I think that, certainly, the overall macro climate, it's hard to ignore some of this terrorist activity that we've seen in Barcelona, obviously, the horrible events we saw in Las Vegas. I mean, there are things going on that are starting to be sort of the new normal. Aside from that, when we look at the macro environment, it still looks reasonably solid, and a lot of the trends that we have seen for some time now look to be continuing. Air ticket pricing is down, which is generally good for us. The lodging industry continues to be relatively strong. Haven't seen a big change there. Car rental companies, kind of up and down, but no significant change there aside from the overall macro shift that seems to be hurting their on-airport locations towards things like Uber, which is obviously a great company. But aside from that, no major change.

I think in terms of share and us, specifically, we don't see a big change in this -- in what's happening with our -- overall, our global growth brands. They continue to do very well. The things that end up hitting us from quarter-to-quarter are some of the smaller brands. I think the regional brands, we mentioned, got disproportionately hit by the hurricanes and other storms. Hotwire is -- has not yet completely found its new footing, so that can be a drag on results. We still have not completely lapped over the shedding of some of the Orbitz Partner Network business that continues to be a drag on the business. So there's little kind of nicks and cuts that hit our results, but no change for the global growth brands. They are collectively doing well and on solid footing.

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

All right. And there's a lot of interest in the alternative accommodation space from a lot of people. HomeAway appears to be continuing to do pretty well. Do you think that's a function of HomeAway winning the market? Or is it rising tide lifts multiple ships scenario? Or is it some combination of the 2?

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

Well, I think it's a combination of the 2. I would disproportionately put -- attribute winning market to them. If they were sitting still and doing nothing, I could say that the -- they're just getting lifted by the rising tide, but they are just pushing a ton of change. It's remarkable how much change that that team has accomplished in such a short period of time, and they're not even nearly done. So I think that they are -- they're winning in the market. Now whether or not they're winning from a like-for-like competitor, whether they are encouraging more people to travel than would otherwise travel, whether or not they're taking from the traditional lodging market, it's hard to say. But we do believe that they are growing significantly faster than the overall alternative accommodations market.

Operator

(Operator Instructions) And we will go next to Akshay Bhatia with Bank of America.

Akshay Bhatia - *BofA Merrill Lynch, Research Division - Associate*

Could you characterize the capex savings you expect from cloud migration over time? And can you remind us what sort of the status is of your new headquarters in Seattle and some of the expenses around that?

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

Yes. So on the capex savings, there's a couple of ways to think about that. I mean, we're already seeing it. You can kind of see it -- you can start to see it in our capex numbers. If you take a look at that we've spent so far this year, that, this year, includes our spending on new headquarters. So we are, in the data center, down already. And it's -- the year-over-year comparison isn't even entirely fair to us because the savings is actually kind of what you would have spent relative to what you are spending. So we're already seeing some benefit there. The real benefit, though, is going to come when we get to -- far enough along in the process that we can actually start to shut down parts of our data centers. We're a little ways away



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

from that. We've not made any final decisions there. We need to learn more in terms of how everything's going and how things are working. But at some point, we will be able to reduce the actual data center size, and that will be more meaningful. It will cut capex. It also, by the way, eventually will cut some OpEx in cost of sales, too.

On the new headquarters, things are progressing. Just from a timing perspective, the vast majority of the work is going to be done in 2018 and 2019. There's been a fair amount of prep work done so far, but there's a lot of additional fitting out of existing buildings and some new structures going up in the next couple of years. We've spent -- we think the whole project, excluding purchase of the land, will be between [\$700 million to \$900]

(technical difficulty)

million. By the end of this year, we will probably have spent around, call it, \$130 million, \$140 million, and so the rest of it will be split, call it, roughly evenly between 2018 and 2019. And we expect to be able to move into the building at the end of 2019.

Operator

And we'll take our next question from Ron Josey with JMP Securities.

Ronald Victor Josey - JMP Securities LLC, Research Division - MD and Senior Research Analyst

I want to ask about hotel acquisitions. I think that's a key strategy for you all. And specifically, Mark, is the team in place and the process in place to, call it, double your hotel count, if that's the goal of, what, the 500,000 as of this quarter? I think earlier, you said hotels create more marketing opportunities and therefore, growth. And we've talked a lot about the cost side. I want to understand the benefit side and where we are in that process. And then when you think about the step-up in investments going forward, between locally relevant, customer care, et cetera, how would you characterize this step-up in investment relative to those in the past?

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

Sure. Well, the team that is required to deliver on the ultimate acceleration in hotel acquisition in 2018 is not yet completely in place. We are in the process of starting to ramp that up. We have not given a number in terms of where we want to get to. I would just say that if you look at our overall property count now at 500,000 available on the OTA side, we've said 95,000 of those are HomeAway. So call it 400,000 or less are actually hotel properties, and compare that to the overall number of hotel properties that exist in the world. I mean, our ambitions are ultimately to connect everyone in the world to every place in the world and give them the full selection of places to stay. So over the course of the next 5 years, that's the direction that we're going to go. We do have, obviously, the processes in place now that we can scale things up. If you look at how many properties we added 3 years ago, would have been 25,000 to 30,000. This year, we'll add 80,000 or so, or a little bit north. So we've just about tripled our capacity over the course of the last 3 years, and we're expecting to do a step change going forward as well.

Yes, there's a cost side of this, but we do this to ultimately to generate revenue. And that comes in 2 -- from 2 sources. One is we have demand on our websites right now looking for properties that we don't currently have signed up, and so signing up those properties allows us to satisfy that demand. But two, if you take the simplest example of trivago that runs hotel-specific metasearch auctions, we are simply not in the auction for any hotel that we don't have, so it also creates the opportunity to drive new demand. So that's the goal here, is ultimately better satisfy existing demand, create the opportunity to drive new demand and in the process, build ultimately a better product for customers around the world, and particularly customers in the countries in which we prioritize.

In terms of investment level, it's hard to characterize at this point. We don't want to get into providing detailed guidance for 2018, although we did provide actually guidance for 2018 a little bit early. But what I can say is that these are investments that, unlike the technology investments we made in the past, that you should start to see some impact at least in terms of room night growth versus what we would have otherwise delivered in 2018, particularly around the back parts, it can take us a while to ramp things up. But you should start to see results, and I think you'll be able to



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

see what we're doing based upon our property count, based upon our indirect sales and marketing expense ramp-up, and ultimately, if we were successful in the short term, in room night growth; in the long term, in better margins. And I think you'll find the investment that we're making is appropriate and will be well returned.

Operator

We will go next to Mark May with Citi.

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

I think given that you're deciding to lean in, in investing in HomeAway, you've been getting this question a lot, but maybe I'll ask it again. Can you try to give us a sense of what the organic online plus offline bookings growth looks like at HomeAway now that you're getting close to over half or the majority of it happening online? I think people are obviously wanting to get a better sense of what the organic bookings growth looks like there, so anything you can add to that would be helpful.

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

Sure. Well, I think, again, we stopped estimating what the total platform bookings were the day that we closed the deal. So we're not -- it's very difficult for us to get a sense of the booking volume that's happening offline. What we can tell you is that traffic on the platform is growing, that the total listing count is growing. So we believe that the overall booking volume, including online and offline, is growing as well. At what rate, it's hard for us to tell. But we're very focused on, obviously, the online piece. So I think it's -- the total bookings growth rate that we've seen online for HomeAway has been pretty consistently in sort of the 35, 45 year-on-year -- percent year-on-year range. I suspect, obviously, that, that is penetrating into the larger opportunity, and the offline piece is growing slower. But I think the whole \$15 billion to -- or \$14 billion to \$16 billion in total platform bookings is -- which is the number we gave at the time of the deal, is significantly larger now.

Operator

We'll go next to Justin Patterson with Raymond James.

Justin Tyler Patterson - Raymond James & Associates, Inc., Research Division - Internet Analyst

Mark, I wanted to unpack your first priority around local relevance on a global basis, primarily in the context of Asia and China. You made the investment in Traveloka last quarter. Your competitor just made one in -- behind Meituan[-Dianping]. How should we think about your approach in that region? And then secondly with HomeAway, it looks like you're taking a gradual approach to integrating inventory on Expedia sites. Could you talk about the timeline to just integrate all of the inventory and we how should think about factors like non-instant booking inventory, listing optimization (inaudible)?

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

Sure. So in Asia Pacific, we've got a multi-pronged strategy there. I think when you think about Expedia, Inc., we are really part portfolio company, part operating company. And the first part of the multi-pronged strategy is about making sure that, ultimately, if there are attractive assets out there like Traveloka, which has really latched on to something special with what they're building there, that ultimately we can be a part of that, not only in terms of investing capital, but also partnering with them to provide their non-direct hotel inventory. So that's piece of it. I -- a piece of it.

I think, secondly, is we have a great business with our Expedia Affiliate Network, which is not only powering the likes of Traveloka where we make minority investments, but it's also out there powering every other online travel agency that exists in China to the extent possible, corporate travel



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

players, offline travel agencies, all of which are pretty significant in Asia, airlines, for example. So even where we don't have necessarily a consumer-facing presence, making sure that we tap into demand from all of those regions, including China, which you mentioned, and driving those -- that demand into our inventory base, both in Asia Pacific but then also outside of Asia Pacific.

And then separately, Brand Expedia and Hotels.com are building real meaningful presences in Asia. Brand Expedia, for example, very strong in places like Hong Kong, building strong presence in Taiwan, starting to grow significantly in South Korea. Hotels.com, very strong in South Korea. Brand Expedia, very strong in Japan. So we've sort of got this combination of investing, combined with our affiliate business, combined with our global brands, and that's not even to talk about Egencia, which is building up a big presence there to serve their corporate clients. So it is really multifaceted.

Asia Pacific is quickly growing to be the largest travel market, obviously with emerging markets there taking -- starting to actually become meaningful for pushing more people into the middle class. The fact that mobile is allowing people to leapfrog the desktop and bringing people more online. We're very excited about Asia, and we are in Asia in many different ways. And we're in it very seriously. And I think if you look over a 5-year basis, there will be many countries in Asia where, at the end of 5 years, we are truly locally relevant in terms of having #1 positions in those markets.

In terms of integrating the inventory from HomeAway onto the Expedia, Inc. sites, I think the first pot of inventory to go after there is the 500,000-some-odd instantly bookable listings. We've got 95,000 of them now integrated into our core lodging stack. And really, the goal right now is to get ourselves in a position where we have real property density across a number of popular destinations, and we've got enough demand, which we now are up to 28 different points of sale, that we can really start to get to statistical significance on tests that we're running around how do you best present this inventory to ultimately deliver the most bookings by essentially matching that inventory with the demand or the customers who are actually looking for it. So that's what it's about. I think we will ramp it up even further here in the fourth quarter and into 2018, and our hope is that we do get better and better at matching the right customer to the right property. Our expectation is that we will. We do not have yet firm plans on integrating all of the other inventory yet, although it is -- which is not instantly bookable, but it is absolutely on our radar. And that is something that could come later on in 2018, but we have no definitive plans at this point.

Operator

We'll go next to Perry Gold with MoffettNathanson.

Perry Scott Gold - MoffettNathanson LLC - Analyst

Firstly, Mark and Alan, congratulations on the new roles.

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

Thank you, Perry.

Perry Scott Gold - MoffettNathanson LLC - Analyst

Absolutely. Apologies if this question was asked already. Mark, at the Skift Forum in September, you said that HomeAway's next priority will be to push into international markets and major metros. Can you comment on the timing and likely level of investment required to go after these markets? And is there a chance this keeps HomeAway's marketing in -- at elevated levels and possibly restricts margin expansion for several years?

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

Sure. Well, I think the broader point there is that -- is really something that we highlighted at the time of the acquisition, which is Phase 1 of this is just taking the volume of activity that they've got right now and they had at the end of 2015 when we closed the deal that was predominantly U.S.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

and Western European and predominantly in secondary and tertiary resort and ski destinations and moving that stuff online. And they are still in the process of doing exactly that.

Phase 2/2a is then expanding their international presence, and Europe is an area where they are setting themselves up for success. It's part organizational, getting themselves into a real Pan-European global organization. Part of it is platform consolidation and getting everything on the same global platform, and they're making good progress there. It's hard for me to give you a timing on whether or not that is going to be a meaningful -- when that will be a meaningful push for them. I think it'll be a little bit more gradual here through 2018, at least from what we see now.

And then the urban opportunity is something that is -- which we called out as kind of the Phase 2, and maybe now I'll call it the Phase 2b. One of the big catalysts there is getting the HomeAway instantly bookable inventory onto our Core OTA sites. Those Core OTA sites, Brand Expedia, Orbitz, Travelocity, ebookers, Hotels.com, just to name a few, have real meaningful volume into major metropolitan centers where there is a significant amount of urban inventory. So step one is to get what they've got in the resort and ski destinations predominantly onto those sites, start actually getting things optimized and working and then, of course, once we get those muscles working, moving that more into some urban accommodations. But it's not priority #1 right now. It is something that maybe we'll get to in -- towards the end of 2018, but it's not priority #1. Priority #1 is get what you got online and monetize it better, and we think they're making great traction on that front.

Operator

We will go next to Kevin Kopelman with Cowen and Company.

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

So I wanted to ask a follow-up on Core OTA marketing. Can you talk about how you're approaching return on ad spend, including what you see as acceptable returns, and also, how you attribute revenue to your ad channels given the complexity of multi-session and multi-device shopping and repeat customer behavior?

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

Sure. So return on ad spend, I'd say no major change to how we've been looking at it. It's -- factor #1 is how much money am I going to make on this first transaction from this traffic that I'm buying. And consideration #2 is how likely is it that this customer that I am introducing to my product is going to repeat with me. And as a general rule, the traffic that you would get in traditional paid search, think about it as the New York hotels blue link. That generally has a higher repeat propensity for our brands than something like a TripAdvisor metasearch link, for example. So because of that, the return factor for metasearch would be a little bit smaller than it would be for the traditional SEM. So that's essentially how we approach it. Again, I'd say no major change to our overall approach.

In terms of how we attribute revenue to the ad channels and how do we attribute to the specific keywords, how do we attribute to the -- all of the keywords they touch, I mean, this is a data science gold mine, which we have a ton of people constantly working on answering this exact question. And I'm just not going to get into the details of that right now. It's something that's, I'd say, proprietary, but it is something we spend a lot of time on. And of course, the most important thing is trying to get as close as you can to spending as much as you can or allocating as much as you can to the channel and the keyword or whatever it is that actually drove the booking. And that's the goal of those teams.

Operator

We'll go next to Heath Terry with Goldman Sachs.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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

Just wanted to get a sense of what you're seeing on the hotel direct side of things. Obviously, Hilton, on their earnings call earlier today, had very positive things to say about their efforts in these areas. And to the extent that you are seeing a higher cost of customer acquisition or higher marketing cost or, put another way, sort of conversion headwinds on the marketing dollars that are being spent, is there any sense that the success that these -- some of these hotels seem to be having with these direct programs is contributing to that?

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

Well, I think the short answer is no. We don't think it's impacting our business at all. We have seen no direct impact on our marketing efficiencies from anything they've been doing. We've seen no real impact on our conversion rates, our marketplace from the discounting they've been doing. So we're just not seeing it.

I think as it relates to their overall push direct, listen, makes a ton of sense to me. I -- we do the exact same thing, which is bring customers onto our platforms, try to give them amazing experiences and try to have them come back to us directly. We -- so we think it makes strategic sense. Now what I would say is that the real way that, at least we think from our humble perspective, that hotels should be thinking about this is that the best way to get customers that are on our channel that are, by the way, brand agnostic -- less than 0.5% of Hotels.com shoppers are looking for the largest hotel chain out there. They really are brand agnostic. And in the last 18 months with all of the discounting activity that's been going on and seeing what that's done to the search results of these hotels, that's only been proven out even more that this is a competitive marketplace amongst hotels on our channel and that, ultimately, this is the basis of competition. So the question is, well, how do they compete in that world. Well, the best way to compete in that world is the way that we compete, again, for our repeat customers, is give them an amazing experience. And it's not through television advertising, and it's not through rewards points. It's not through a discount. It's actually through giving them an amazing experience on property. And if they do that, they're going to build great loyal customers, customers that hopefully will come back to them again and again. But even if they don't come back to them again and again, customers that ultimately choose that hotel the next time they're shopping on Expedia or Hotels.com. And that's where I hope we can shift the dialogue, but I think their book direct, overall, that intent, I think, makes a lot of sense.

Operator

We'll go next to Brent Thill with Jefferies.

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

Just a clarification on the shift to cloud away from your own proprietary infrastructure. What's the duration that you're putting behind this? I know there's associated costs sort of ramping. But when you look at the completion, is this 2 to 3 years out? How do you think about the end goal of when you'll be pure cloud?

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

Yes. Well, so it remains to be seen if we'll be pure cloud. I think there's a chance that we may require some of our own data center capacity indefinitely. But in the spirit of your question, at the point at which we think we'll be vast majority cloud, I would say it's a 2- to 3-year effort.

Operator

We'll go next to Dan Wasiolek with Morningstar.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

Dan Wasiolek - *Morningstar Inc., Research Division - Senior Equity Analyst*

As you look to expand and accelerate your international offering, just wondering if maybe you can give any commentary on how that would potentially impact international take rate, if at all. Just any kind of view on that as we look out into 2018?

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

Sure. I mean, I -- it obviously depends on how you're looking at take rate. We don't anticipate a significant change to our overall hotel margin mix as a result of this. There could be slight as we go into some markets that have lower structural margins, but there's nothing right now that says that's going to be a dramatic impact on our business. I think that if you look at take rate from the purely financial standpoint and look at international gross bookings versus international revenue, I think as we go more international, I think the first step is to actually ramp up our hotel acquisition efforts and get more hotel inventory, and that could drive more mix into hotel, which could be a positive for our overall take rate defined by that sense.

Operator

We'll go next to Michael Millman with Millman Research Associates.

Michael Millman - *Millman Research Associates - Founder*

Could you talk about Egencia? Particularly interested in how much of the growth is market share and how much, if any, of the growth is improved corporate travel. And maybe you could also break that out geographically, U.S. and international.

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

Glad you asked about Egencia because we're pretty excited about it. I'd say that it is all growth in market share. Egencia has been consistently growing at 2 to 3x faster than the overall market. The overall corporate travel spend environment has been actually pretty consistent over time. You're talking about flat to up slightly low single digits really, not a significant change in the overall dynamic by region. Obviously, in the emerging markets where overall activity, business activity is growing quicker, you see quicker growth in corporate travel spend, but not a significant driver. So it is really all about growth in market share. And of course, Egencia is taking essentially consumer experiences built by the best-in-class in consumer-facing online travel agencies and putting them in the hands of corporate travelers, and that just resonates with people. So their offering is resonating really well with the corporate travel market, and we are investing aggressively behind that. We mentioned we ramped up their sales force. That continues to go well. They had a record new client signing in Q3, which we are really excited about, and I think that we are, I think, very early in the stages of what Egencia can become. I think it's going to be a big part of this business, and I think 5 years from now that will be all too clear.

Michael Millman - *Millman Research Associates - Founder*

So is it picking up share from OTA or creating OTA customers?

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

Well, I think it's more likely taking it from traditional travel management companies or taking companies that used to work with traditional offline travel agents, some of the smaller ones, and moving them online. I don't think there's a lot of share coming from OTAs at all. In fact, I think there are some OTAs, including Hotels.com and some of their other competitors, that have a pretty significant part of their business that actually comes from business travelers. They're just not in a managed sense.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

Operator

We'll go next to Naved Khan with SunTrust.

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

I just had a question on the international room night growth, 22% this quarter versus 26% in the prior quarter. Was most of the slowdown because of the change in trivago? Or was there anything else driving it?

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

Yes. I think the majority of it is Easter. I do think there's a possible element that's associated with trivago's changes, but those would be the 2 primary factors.

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

Okay. And then just quickly following up on this trivago change. Are you able to redeploy those dollars into other channels? Or how does it work when you look at the spending?

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

Well, essentially, we're always optimizing our marketing spend within channels and across channels. I'd say that, within each channel, we've essentially got efficiency and growth targets. And so whether or not actually a change in trivago results in a change in another channel, I couldn't be too specific with you on that.

Operator

And at this time, there are no further questions. I will turn the conference back over to management for any closing remarks.

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

Great. Well, I'd just like to reiterate I'm thrilled to be at the helm of this great company. I want to thank all of our amazing Expeditors for yet another quarter of great work. And boy, we're really excited about the next chapter, and we look forward to delivering it with all of you. Thanks to all of our investors, and we look forward to talking to you at conferences across the quarter and, of course, on our next Q4 call.

Operator

Ladies and gentlemen, this will conclude today's conference call. We thank you for your participation, and you may disconnect at this time.



OCTOBER 26, 2017 / 8:30PM, EXPE - Q3 2017 Expedia Inc Earnings Call

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