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PRESENTATION

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

Good afternoon, everyone. My name is Paul Bieber. I cover the OTAs and Expedia at Crédit Suisse. Thanks for joining us, and we're very excited to have Alan Pickerill from Expedia join us.

QUESTIONS AND ANSWERS

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

I guess, to just kick things off, Alan, you've been CFO for, I think, 2 or 3 months after being with Expedia for a few years. What's your favorite thing about CFO? And what's your least favorite thing?

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

It's a good question. Well, listen, I was coming from -- well, I've been with Expedia now for 10 years, coming from responsibility area of covering investor relations for all of that time period and then also for the last 2 years, acting as the Treasurer for Expedia. And so I think, most favorite I would say is it's going from somewhat narrower remits to a much broader remit, and there's so much to learn and so much to do in the company that's exciting. So I would say just kind of going into that role is probably my favorite part of it. Least favorite I would say is just that my everyday is pretty much stacked with meetings from about 7 in the morning until 6:00 at night. At which time, I get to start taking a look at my e-mail and do other work. So that's probably my least favorite part.

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

So it's a pretty volatile earnings season for the OTAs. And I don't know how many times I've [spun] the question over the last 2 months. Are we seeing a structural slowdown in demand or a structural issue on online travel? What's your view on that question?

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

We continue to look at the global opportunity the same way. I mean, we are a single-digit market share owner in the global travel market, which is, call it, $1.5 trillion of spend on travel on a global basis, and we're doing just a single-digit share of that. So our global growth ambitions haven't changed. We have intentions to build this business out over the next 5 to 10 years and over that time, be a much bigger participant in the market. The -- just in terms of our performance this year, look, we've grown our room nights right around 17% for the first 9 months of the year. If you normalize Q1 and Q2 for the Easter shift, it was 17% room night growth. If you normalize Q3 for a little bit of a hit on the hurricane impact, 17%. We've got our global growth brands, Hotels.com, Expedia, our private label business, EAN, and Egencia as a group grew room nights 18% in Q3, again, some impact from the storms and somewhat north of that earlier in the year. So we look at our progress as being quite good.

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

So just want to dig a little bit deeper and sort of question about potential structural slowdown. And I was at Phocuswright, and I came away from that thing with the opinion that we're not seeing that. But there are several things on the periphery that may be impacting growth, market maturities, supply direct momentum, Airbnb and alternative accommodations. Maybe you could just spend a couple -- a minute on each one of those issues on the periphery that may be impacting the industry or may not be impacting industry.

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

Yes. Well, I would say as far as supplier activities, and I assume that's principally focused on hotel chains and activities that they've been undertaking to try and drive direct traffic and build up their loyalty programs and all of those things, have been going on for quite a while and that continued into 2017. In fact, I would probably say a lot of their efforts were stronger and certainly more vocal in 2016 than they have been in 2017 by my assessment. But what we do is we take a pretty close look at the performance, our performance in markets where we know they are chain heavy and our performance in markets where we know it's chain light, and we try to see is there some kind of a correlation that you can draw based on these activities. And we just can't see it. Now I won't sit here today and try and convince everybody that they -- 0 hotel chains have had 0 impact. I mean, certainly, around the margin, maybe there are some things that they've done there. But the hotels have quite an uphill battle. I mean, they are trying to create a situation of brand loyalty, and what we know to be true is that the vast majority of the people -- in fact, I'll put it the other way. A very, very small minority, less than 0.5% of the people that come and search for hotels on Hotels.com, for example, actually enter the name of a specific hotel as they try to refine their search. So we know that the average leisure traveler is looking for not necessarily a specific hotel in a specific city, but they're deciding to go to a particular destination, and then they're trying to find what is the gamut of supply that I can choose from. And so aggregation, as we do it, is super valuable in that circumstance. They can see all of the choices. They can see all of the prices. They can see the amenities, and they can make decisions about where they want to stay. So that's a fundamental truism of the leisure traveler market, and we think that, that will remain. We do a similar exercise with Airbnb. So we can look at markets where we know Airbnb inventory is heavy and where we know Airbnb inventory is light. And the same analysis can be undertaken, and we can't see a specific correlation of our performance that would indicate they're having a net impact on our hotel volumes. What I will say that both Airbnb and HomeAway are doing in the industry in certain circumstances is in compressed markets. So you can have a market where there's an event going on. Maybe it's Dreamforce, for example, in San Francisco where the hotels all get sold out. It used to be much easier for hotels to mark up their hotel rooms. They could start pulling back distribution from their distribution partners under the knowledge that they would be able to sell those rooms out even at the higher prices. And what we've seen more recently in the last couple of years is that while they still are trying to yield up as anybody would in those markets, they are not necessarily as eager to pull back their inventory from their distribution channels. In certain circumstances, we've actually seen quite good results in terms of the volume we've been able to generate in those markets by virtue of the fact, we think, that there is some supply available through Airbnb and HomeAway in these compressed time periods.

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

So on the recent call, you announced the -- one characterized as an investment cycle. I think there are a couple of main areas you're investing in, cloud, international supply, marketing. Can you spend a few minutes on each one of those investment areas and the scope and size of the incremental investment in each one of those areas and why they're important for Expedia at this point in time and maybe why they weren't done in the dark?

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

Yes. So the one thing I would just say to kind of clear this up a little bit is that when you are trying to undertake a multi-year, one could argue, a multi-decade endeavor to grow a global business, you are, by definition, investing every year. You're making decisions about how hard do we push in Latin America, how hard do we push in Asia-Pacific, how hard do we push in a market like Russia. And you're making decisions about allocating capital to those efforts, putting market managers in those markets, deciding what kind of marketing spend you're going to accept. So by definition, until we rule the world, we'll be under investment, a form of investment mode all the time. But what we've been, we think, reasonably effective at doing is making good tradeoffs, operating in a constrained environment, making good tradeoffs and good bets where we do deliver healthy profits and profit growth, but we also invest in the business as we think appropriate to build it over the long term. In terms of kind of how we're looking at 2018 and beyond, it's really pretty straightforward in that we -- the global ambition has not changed. We still think that opportunity is there for us. We need to execute very, very well to get it. But we think it's there for us. But historically, we had a little bit more of a scattered gun approach, I'll call it, where we plant flags, Hotels.com in 75 or 80 countries. We've got hotel -- Brand Expedia in 35 points of sale. And when you do that, it's fine. You set up your global business, but you are constantly, I'll call it, arm wrestling to determine how many market managers do we put in this country, how many -- how much marketing spend do we put in that country. And the shift here really is kind of saying, well, how about instead of that effort, why don't we just choose a handful of priority markets that we think are most important to get after today. Let's hire the market managers that we need to hire to close the supply gap in those markets. Let's make sure that we've got all the payment methods that are required by consumers in those markets to be effective e-commerce company and make sure that content is localized in such a way that local consumers can consume it the way they like to consume it and read it the way they like to read it and book travel. And so it doesn't change the long-term goal at all. It's really more about what's the focus and how do we achieve that. If we're successful, then what I would anticipate is, in those priority markets over time, we would start to see, well, a, we would see that supply gap closing. We would see better booked room night growth in those regions, and we would obviously eventually see better stable room night growth after that. And then, presumably, we would also see just a better overall business where you're bringing in more repeat customers, you've got more direct traffic, you're generating more profits. So then you can let some of that fall to the bottom line, and you can also reinvest that into additional international expansion. So the long-term goal is still there. We've got the market manager investment I just spoke of. We are -- and somewhat separately, we are investing in migrating to the cloud. We've talked at length about that. But for those that haven't heard, we've undertaken a project, significant effort in 2017, will continue to be a significant effort in 2018. We're removing a lot of our compute power out of our data centers and into the cloud, principally Amazon Web Services. And that requires an initial investment by way of almost double capacity, where you're paying for the capacity in AWS and you're also running these data centers to run your business. Eventually, once you get all of it into the cloud, then you can start to shrink and possibly eliminate data centers, which will provide relief on CapEx in -- and operating expenses in those data centers. And then once you hit that normalized state, then you're just going to be paying for compute power that you need in the cloud that will accommodate the growth of your business. And there's a lot of -- I mean, we think, a, it will be cash flow accretive in a reasonable period of time, but we also just think, from a pure business perspective, it's a great move because the products will be better, the data centers will be more efficient, the -- way less latency. There's some data analytics capabilities that we don't currently have. You can provision capacity almost immediately where you can't do that in your own data center where you've got to set up boxes and put them in racks. So we think it's a very good decision, and we think it's going to be good for the business long term. But for a few years, it provides a headwind to EBITDA growth.

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

Just a quick follow-up on the international supply investment. The priority markets initially, are they in Europe? Are they in Asia? Where are the priority markets?

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

So we have not -- the short answer is yes, they're in Europe or Asia. We have not been specific yet. We are inclined to kind of keep that as [close to the rest] for the time being, and we'll share a little bit more about that down the road.

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

So let's talk a little bit more about the cloud migration. The cloud migration, because of it, the income statement basically has double expenses. You have the depreciation, and you have OpEx from the cloud. When will some of the depreciation expense start rolling off the income statement? And potentially, when do you think you'll be able to shut down a data center or several data centers?

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

Yes. So the -- it's an interesting conversation because there's kind of just a pure year-over-year view, which is kind of the angle of your question and admittedly, I think mostly the angle people would be taking in determining how this is working. There is another angle, which is just avoided cost. So there is a reasonable chance that if we had not decided to move into the cloud that we would, at this time, be building out another data center. And so by virtue of the work that we've done already, we have avoided having to increase capacity and build out another data center as significant presence. In terms of just the year-over-year view, I mean, I think this is a -- we started really initially kind of testing some things in 2016. We got a lot more aggressive in 2017, and 2018 will be another big year. I think we are already seeing some relief on the CapEx side. It's not completely offsetting the spend by any stretch of the imagination. But we're starting to see some year-over-year relief there. And so the depreciation will trend along with that. As far as actually reducing the size of and/or eliminating a data center entirely, we've not made that decision yet. From a timing perspective, we are looking at it. Conversations are happening. We've got to make sure we're confident that we're going to get everything that we need in the cloud to actually start to reduce that size, and we're just not quite ready to make that decision yet.

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

So you recently walked down the $350 million target for HomeAway in 2018, and I think you had 2 main drivers. One is marketing investments internationally and then cloud investments for HomeAway. Can you give us a sense of the scope of incremental investment for HomeAway? Is most of that going to -- towards marketing as it becomes more online bookable? Or is most of it going towards cloud?

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

Yes. So what we've shared so far, and I probably don't want to add much to that today, is that we got far enough through the planning process to see that it looked like HomeAway would need to spend nearly $30 million on their component of migration to the cloud in 2018. And they did spend some this year, but you can think of that as being kind of in the single-digit millions. So it's a significant increase in terms of that overall spend. And look, we -- it's possible that we could go through some machinations that would -- and do some, what I'll call, unnatural things to try and make up for that in order to deliver an EBITDA amount in 2018. But our perspective really is that while we think it's important for them to hit milestones, we also think it's important and probably more important for them to position the business for excellent long-term growth. And so that's what we're really looking toward. And along those lines, the team does now have -- by virtue of all the transition that they've undertaken so far, they do now have the unit economics that you need to do search engine marketing. They have stood up a proper search engine marketing team. They are adding people and processes and technology and tools in order to be good at that. Remember, HomeAway really never had a mechanism for being good in search engine marketing historically, but now because they've got those unit economics, they can. And so their inclination is to lean in a bit on that kind of marketing, and I think our inclination, both Mark and I are inclined to let them proceed with that because we are focused on the long term. Presumably, if that component is executed well, there are returns to be had. Now depends on when they spend it, they do have a very long booking window, and we'll see how much of that gets spent at different times in 2018 and whether those returns are in '18 or '19. But presumably, if they are effective at it and they get better at it, then there should be returns for that spend.

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

Let's chat a little bit about metasearch. Obviously, a lot of volatility in meta. How are meta ROIs trending? And if Priceline has pulled back from that area, isn't that an opportunity for you to actually step in and take advantage of that?

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

So I don't -- I mean, I don't want to make any comments that appear to be commenting on what we're seeing today in various channels. I think we'll save that for our earnings call. I think the way to think about how we think about operating in these performance-based marketing channels is that we are obviously looking at the channel for growth opportunity. We're looking at it to see how competitive it is, what's that dynamic look like, are we losing share, are we holding share, are we gaining share and trying to decide how important that is to us and what we do about it. And in many times, historically, you have a situation where you might have a channel where you can see a competitor getting more aggressive, and maybe they're spending more. And they're -- it looks like maybe they've either driven better conversion rates for themselves or they've reduced the returns they expect to get in that channel or they're just testing something. And it's the team's responsibility to respond to that and think about, well, what should we do. Do we think this is a temporary thing? Is it permanent? How should we respond if you will. The same holds true if it goes the other direction. And so the teams -- anytime the teams sees a competitor pulling back in a particular channel, it can provide an opportunity to either stay aggressive and in favor of unit growth. It could provide an opportunity to kind of get less aggressive and hold share but see better profitability in that channel or a combination of both. We're not really at liberty to talk that much about kind of what we're doing specifically right now because this is live-action and dynamic and happening as we move forward. So these will be things that we'll continue to monitor and navigate.

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

Have you had a chance to see Google's recent changes to the hotel search UI? And if you have, is it more of the same? Is Google making changes? Or is there something different?

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

Yes. I think on -- in large part, it's more of the same. I mean, Google has spent the last -- really, the last 10 years trying to figure out how to make their products look more like metasearch products, trying to deemphasize free search and push it down the page, trying to make sure that they're increasingly monetizing paid search, and they have largely been effective at doing that. We have, for our part, I think been pretty successful at navigating those changes. It tends to work well for us in most respects because we have big budgets for tech and content development. We can work very hard to drive our conversion rates up. We can do the things you need to do to perform well in a metasearch style channel. And so we would expect that to continue.

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

So when I look at the inventory coverage of Booking.com versus Expedia, you touched on briefly international supply investment, and that's one component as the supply difference. The other component is alternative inventory. When will we be able to see more HomeAway inventory on Hotels.com and Expedia? I assume that for Booking.com, the amount of alternative inventory that they have helps with their conversion rate. So I think now you have less than 100,000. When will it be hundreds of thousands?

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

So to be clear, there's one component that I think is maybe not well known, which is that our supply portfolio does actually include some element of what would probably be classified as alternative accommodations at Booking.com, for example, that we contract directly. Typically, that's professionally managed inventory that has a -- it qualifies as alternative accommodations because it's owned by individuals, but it's largely run professionally and like a hotel would be run. So that will continue, and we have opportunities to build that inventory out as well. As far as the HomeAway inventory, in particular, you're right to say we disclosed I think about 95,000 properties that have been integrated principally on -- well, on the Expedia platform and across other brands that are on the Expedia platform. And that work continues. We have to continue to test that. We got to determine exactly when do you surface it, for which travelers do you surface it. There are still some tricky things to work out in terms of the fact that you're potentially showing, on the one hand, a hotel that is either recognizable or fits a certain mold, and then you're showing that against inventory that's quite unique and trying to figure out how you do that in a way that's not disruptive to your customers. So that work will continue. So I would expect us to get better and better at that. I would also expect us to continue to add initially the instant bookable properties on HomeAway, which we've said is about 500,000 listings. And then it's starting with Brand Expedia, and then Hotels.com will follow.

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

Are there any questions from the audience before I continue? No? Okay. So which competitor -- potential competitor worries you the most, Airbnb, Google, Priceline, Amazon or the hotels chains?

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

I don't like this question. Look, I mean, well, I would say, let me start from the bottom. I would just say that's -- the hotel chains have been doing what they've been doing for a long time. I explained earlier our point of view on that. I think we could be proven wrong. But I think we have a very, very strong value proposition for consumers that are not brand loyal and will never be brand loyal to a particular hotel chain. We have the Hotels.com loyalty program, which is, in my mind, better than the loyalty programs you can get directly from the hotels. It's book 10 room nights get 1 free, and you don't have to be brand loyal. So you can stay at a business hotel for all of your business travel and then stay at a leisure hotel for your vacation so super compelling, and I think that's an uphill battle. I think that they'll continue to try and chip away at it. But -- and then Amazon has been -- has tried some things in travel, and I would not discount them entirely at all. But they've tried a couple of times, and I think the last time was several years ago. And it lasted about 6 months, and they shut it down. So I'm not sure -- like I say, I wouldn't ever count Amazon out, but certainly, they're not doing anything that I'm aware of that would be immediately concerning. I think, look, all of the other ones you mentioned are -- they've got their place in the travel industry. They've got their approaches. They've got different strategic ideas that would, if executed well, will have an impact on us. But I think we tend to just shift our focus to what do we control. And regardless of those guys, we think the opportunity is pretty good and a long runway. And if we execute well, we think the opportunity is pretty good for us.

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

So as we look out to the long term, what do you think will be the biggest driver of value creation for Expedia, HomeAway or Expedia core, yes?

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

I don't really want to handicap, but I think we've got really tremendous opportunity for value creation across the portfolio. I think this work that we've talked about today and earlier on our earnings call and in other venues around really getting focused on these priority markets, closing the supply gap, really building businesses in those countries and regions that are full, complete businesses is super compelling and a very interesting position to be in. We also have the world's only full product, truly global online travel agency in Brand Expedia. There's nobody else out there that has the global footprint of Brand Expedia and all of the products that Brand Expedia has to bring to bear, and that's something that, I think, we can continue to leverage and chip away at. But look, I mean, HomeAway's been great. We've been very pleased with the progress that team has made. We've owned the business now for just shy of 2 years, and there were a lot of big question marks about HomeAway making the transition they needed to make. And for the most part, that has gone very, very well. So we're super excited about what they can do over the long term.

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

We're out of time, but thanks for joining us. Appreciate it.

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

Thank you.

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

Thank you.

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

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Thanks, everybody.