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# EDITED TRANSCRIPT

EXPE - Expedia, Inc. at RBC Capital Markets Technology, Media & Telecommunications Conference

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## CORPORATE PARTICIPANTS

**Mark Okerstrom** *Expedia, Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Unidentified Participant** - *Analyst*

## PRESENTATION

**Unidentified Participant** - *Analyst*

Mark is also the CFO. Mark will spend a minute or two providing people with an overview of Expedia I'll go into some questions and then we'll leave a little bit of time, again, for Q&A.

Mark, thanks for being here. The mic is yours.

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Thanks. Great to be here.

I think the way to think about Expedia is Expedia is, firstly and foremostly, the largest travel company in the world. And the travel industry is an absolutely massive industry. It's over \$1 trillion. Expedia is the largest and we've got somewhere between 3% and 4% of the overall travel opportunity.

It's a business that's a market which is transforming. It's transforming from a business that used to be very service-oriented to a business that is technology-driven. We, over the course of the last three years, have fundamentally replatformed the major Expedia, Inc. properties such that we are now operating on industry-leading technology platforms. And that has led to some really healthy growth [forays] across these Expedia, Inc. properties.

The Expedia, Inc., properties include a leading corporate travel business in Egencia, which is the fifth largest corporate travel business in the world, growing and taking share from traditional competitors such as American Express and Carlson Wagonlit. It includes brand Expedia, which is the largest full-service online travel agency in the world, operating in over 30 countries around the world -- really, the only remaining global player that sells air, car, hotel and packages; a standalone hotel business called hotels.com, which is very focused on having just perfect global coverage and tremendous breadth of inventories. And then we've got strong global positions in both eLong, the number two online travel agency in China, a huge market with huge potential. And then also a recent addition this year with Trivago, which is the leading hotel metasearch player in Europe, expanding globally.

So, Expedia is really a portfolio of travel businesses which is very focused on gaining share, and a very huge opportunity. And I would say there is a lot of runway ahead of us.

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## QUESTIONS AND ANSWERS

**Unidentified Participant** - *Analyst*

All right, thanks, Mark. There's a lot of parts to Expedia, the portfolios you mentioned. Which of the parts of the portfolio are performing best right now, from your perspective? And then I'll ask you what you're performing not so best?



**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes, sure. I would say that we have got healthy growth rates across all of our businesses, with the exception of Hotwire, which we did mention on the last call still down year on year. Although we are seeing trends stabilize.

A couple of callouts I would make, however. Brand Expedia is doing particularly well. That is the business that we really finished the large part of the replatforming effort of simply rewriting a website that was built in the late '90s, early 2000s to a modern technology platform. That is the business that continues to do very well. It's gone from a business that releases three or four times a year to a business that now is running simultaneously 50, 60 different versions of the website globally, multi various testing different versions. When we see something that works, we roll it out globally. Performing very well.

Interestingly this last quarter, we started to see the impact of some of their air replatforming efforts. And we saw a resumption of growth in the air business. So that is doing very well.

We continue to be very excited about eLong in China. It is a tremendously dynamic competitive environment. But we're very happy with our position there. We've got a local management team who is executing very well. We think we've got a position in China unlike really any other American Internet company, and having the number two OTA there.

And then we are also very excited about Trivago. Trivago is a business that is the most recognized hotel search brand in most major countries in Europe. We brought them into the US this year. We are very happy with the progress. They are in Canada, they're in Australia. They're launching, really, around the world. And it is a business that we are excited to have part of the portfolio. And they continue to execute very well.

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**Unidentified Participant** - *Analyst*

Just at a high level for a second, big picture secular growth opportunity for online travel. It's probably the most penetrated category online. It's just been a natural product and service to sell online. When you think about the growth over the next five years, what is the evidence to you that you're still somewhat early stage, early innings, whatever, in terms of the growth of the sector?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

If you look at our most mature market, which is the United States, we sell about 1 in every 20 room nights. Sometimes it goes a little bit higher. That's in our most mature market. And if you look at the overall hotel industry, where the bulk of the profit for OTAs come from, the average big hotel would be, call it, one-third corporate business, one-third groups business, one-third leisure business. We are in a position where we have got access to all of that through our leader brand, our Egencia corporate business. And so we've got access and yet we're only about 6% of the hotel market in our most mature market. So, we just see a ton of head room.

And then, of course, if you look at the rest of the world -- Europe, Asia, Latin America -- where online penetration ranges from, in Europe, call it, the 40%, Asia, 20% to 30%, Latin America a little bit lower, you have that same story as you have in our most mature market. And yet we are relatively underpenetrated. And online is relatively underpenetrated. So we're very optimistic about the growth of the industry.

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**Unidentified Participant** - *Analyst*

One of the biggest trends in consumer Internet is mobile. People are using mobile devices to access the Internet for Internet services. I think you're just a natural beneficiary of that. I'm particularly interested, though, in the same-day bookings opportunity. And I have a sneaking suspicion that's actually becoming material to [iburrow] bookings for all the OTAs. Do you feel that is the case? Is this a new growth segment or am I overstating it?



**Mark Okerstrom** - *Expedia, Inc. - CFO*

No, I think it is absolutely a new growth segment, and particularly on the smartphones. I think we see a different story with tablet where the behavior looks a little bit more like desktop. But for our smartphone bookings, we're looking at anywhere from 50% to 70% of our bookings are happening for same day or next day.

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**Unidentified Participant** - *Analyst*

50% to 70% of your bookings on smartphones are for same day bookings?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

You got it. Same day, next day. That is in contrast to our average desktop booking windows, which vary across our properties. But of more of these are 15- to 30-day booked day window.

We believe that business is incremental. We believe it is a business that we did not have historically. These are bookings that are happening in roadside hotels or in small European cities as travelers are using their hotels.com app as opposed to looking to their guidebook and making a phone call. So, we are very happy with what we've seen on mobile. We think it's incremental. We think it is a great share gain opportunity. We think that it is a great opportunity for more customer loyalty. And we're investing aggressively behind.

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**Unidentified Participant** - *Analyst*

One of the reasons people have been very interested in Expedia stock is because of the long-term margin expansion. There was a comment made on the last earnings call about how -- something about being close to the end of major investment cycle. You've been doing a replatforming of the company, it seems like forever, but for the last two or three years. Are we at a point now where we should actually start seeing reasonable coverage now showing up in the model beginning in 2014?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

We were pretty happy to be able to demonstrate visible progress towards our overall target P&L that we have put out at the time of the TripAdvisor spinoff in Q3. We believe that our core OTA business, which I would put eLong, Trivago, and Egencia off to the side and deal with the rest of our businesses, in a spot where we can really grow and scale those businesses.

What that means for us is that we think -- and this is something that we have said very publicly -- we think we can leverage cost of sales over the long term. We think that technology and content is something we can grow in line with or slower than revenues, such as you saw this past quarter. G&A is something that we're going to leverage. Sales and marketing people, or indirect sales and marketing, is something that possibly we will be able to leverage, or at least grow in line with revenue.

And the real delta for us between meaningful EBITDA margin expansion or not should be, over the course of the next foreseeable future, really a product of what we decide to do on direct sales and marketing. We're very focused on driving bottom-line growth, adjusted EBITDA, EPS, free cash flow growth. Sometimes that's going to come with EBITDA margin expansion. Sometimes it's going to come with contraction. But given the scale of the opportunity ahead of us, we are more than happy to invest aggressively in the growth opportunity ahead of us.

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**Unidentified Participant** - *Analyst*

Are most of the platform projects are largely redone? And I'm sure it is never done but mostly done?



**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes, I think the days of the technology and content growing in the mid-20% or 30%, as we've seen, are behind us. The bulk of the work is done. It was a huge project. It is largely complete. And you should see technology and content grow in line with or slower than revenue for the foreseeable future.

The piece that still remains is we are integrating an acquisition we did for our Egenia business, called VIA Travel. We're putting that business on our technology platform. And that is some investment that we continue to make. But overall we are happy with our ability to scale on technology and content going forward.

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**Unidentified Participant** - *Analyst*

Sales and marketing is the biggest cost. It always has been for all the OTAs. Is there any potential reason why there would be greater leverage out of that line in the future? Are there any new marketing efficiencies? It seems like what has caused the pressure there is more competitive search marketplace. Is there something about the likes of, I don't know, Facebook or Twitter or some other format that is going to cause some great leverage opportunities?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

It is possible. I think we are seeing encouraging signs in mobile, particularly in the app world where we are seeing nice healthy repeat usage behavior from apps. What we don't know is whether or not that is being driven by the fact that our most loyal customers are the first ones to download our apps, or whether or not this is something we can expect as we drive a longer app download or broader app download footprint. So that is a possibility, I think. Social, maybe.

The biggest opportunity for us that we have seen historically for driving sales and marketing efficiency, which we have decided to reinvest in variable marketing channels to accelerate the top-line growth, has really just been across the board making our products better. Replatforming these businesses, running 50, 60 tests concurrently, and testing against our 10's of millions of unique visitors every month gives us scale to have better products than subscale players. And in our business, the biggest driver to performance is conversion, which is ultimately a customer satisfaction metric.

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**Unidentified Participant** - *Analyst*

And that has risen quite noticeably over the last year or two?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes we've been very happy with the conversion gains we have seen, both at Brand Expedia and hotels.com. We've been very happy with the conversion gains we've seen as we've rolled out our Expedia Traveler Preference program. Which is a program which allows consumer to either book and pay in advance with us, which is the merchant model, or Expedia Collect, as we call it. Or an agency model where customers book with us and they pay at the hotel at the time of stay, which is the predominant booking method in Europe. And really it has been technology enhancements and the Expedia Traveler Preference program that's driven nice conversion benefits for us.

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**Unidentified Participant** - *Analyst*

How broad has been the adoption of the interest in ETP?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

We've got about 30,000 hotels launched now from a point-of-sale basis. Virtually all of our points of sale on Expedia, all of our points of sale on hotels.com offer the Expedia Traveler Preference program, or consumers the choice across those participating hotels. We have over 220,000 hotels on the platform. So there's still a lot of room to go. But, generally, when we have approached hotels to sign up the program, they've been very happy with the results they are seeing. And we're seeing great traction.

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**Unidentified Participant** - *Analyst*

I think you've said that on average it is about 50-50 in terms of how people select.

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes. For customers that are booking on the hotels that we have got involved in the program, when given the choice, generally the mix has been 50-50 -- 50% merchant, or Expedia collect, 50% hotels collect. When you throw in for those hotels' package bookings, non-refundable rates, all of the things that just are not agency, they are not hotel collect, you get to about a 25% agency or hotel collect mix.

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**Unidentified Participant** - *Analyst*

Do you think ETP has helped or can help Expedia gain share the European market?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes, absolutely. I think we have got a ton of opportunity there. And having great supply in the agency format is a huge piece of that. Now, we acquired access to agency hotel inventory in 2008 when we acquired the Venere business. And that was about 30,000 hotels that we made available pretty quickly on the Expedia hotels.com platform. But really only in secondary and tertiary markets.

The Expedia Traveler Preference program allows us to bring agency into the big primary markets where we have not had it. And it is a very popular choice with consumers, particularly in southern Europe. So, we think that can be a big catalyst for us going forward. Remember, the other pieces of the pie, that we've really just built over the last couple of years, is having a global multilingual website, having global online marketing platforms that allow you to acquire traffic on Google in any language, and drop on a landing page. And manage efficiencies on that basis. And those are the other pieces of the pie that we have built.

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**Unidentified Participant** - *Analyst*

Let's switch gears a little bit to Trivago. And I'll just ask one or two last questions and open it up. Just remind us of the rationale behind Trivago and how that acquisition is going so far?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Sure. Trivago, firstly and foremostly, is a business that has got just a huge amount of traction. It is a business that has doubled revenue every year since 2008. It's a business that has been able to consistently go into European markets and build a leading brand presence and really build customer loyalty across Europe.

For those of you who don't know, Trivago is a metasearch business. It's similar to KAYAK, but it is very focused and exclusively focused on hotel. And what consumers love about metasearch, and what they love about Trivago, is that with one visit, a consumer can see on Trivago over 720,000

different properties. They can see all of the OTAs since it's supplier direct. So when a consumer goes to Trivago, they are guaranteed to see all of the inventory available, and generally guaranteed to see the best prices. So consumers absolutely love it.

We saw the business just had tremendous traction. We saw metasearch being an increasingly important part of this industry. And we just had to have it.

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**Unidentified Participant** - - *Analyst*

Is this a way to help generate leverage in your marketing line? Were you working with Trivago aggressively before? And is this now a less expensive way of customer acquisition?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Trivago has been a marketing partner for us for some time, particularly in Europe. I think if you look at our P&L, I think we've certainly looked at having media businesses as a way to have a natural hedge against CPC inflation. But, really, the rationale there was much more on a standalone basis, which is it's a great business with great traction. We think we can do a good deal on it. We think that we can help them. We certainly have, as they've come into the US. And we think that they can help us learn more about how we compete more effectively in metasearch.

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**Unidentified Participant** - - *Analyst*

And you mentioned metasearch -- a major channel for you, I think, has been TripAdvisor over the years. They've just gone through a major change there and insisting that they are generating much higher quality leads for people like Expedia. Is that true? And are those leads worth dramatically more to Expedia?

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**Mark Okerstrom** - *Expedia, Inc. - CFO*

Yes, the quality of leads generally that comes out of metasearch are higher quality. And that is because, when someone comes out of metasearch, you know what hotels they are looking for. They've generally already decided that that hotel is in their consideration set. And you ready know the dates of which they want to stay.

If you compare that with typical Google search engine marketing, all you know is that the consumer is looking for a hotel in New York. So, less qualified. And when TripAdvisor transitions from just pop-up windows where they popped up three windows, you were one of three OTAs, and they went to metasearch where you were really only one of one, the traffic did become more qualified, worth more to us.

As we transitioned, and as everyone transitioned, what we decided to do was pull back on TripAdvisor channels. Certainly you saw that in Q2, and you saw the trends improving in Q3. We did that because, of course, when you go through a transition like this, you just do not know how well that traffic is going to convert. Generally consumers shop on day one, they will end up booking their travel day 30, day 45. And it takes you that long to understand how well the traffic is converting.

So far, now that we've got enough data we actually like what we see. We were able to start spending more on TripAdvisor as we got more confidence as we moved through Q3. And we expect be in a position to grow our spend with TripAdvisor and have that be, again, a nice channel for us going forward.

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**Unidentified Participant** - - *Analyst*

Any questions from the audience at this point? (Inaudible)



**Mark Okerstrom** - *Expedia, Inc. - CFO*

Sure. Metasearch has a challenge in mobile. The challenge they have is that they have a number of advertisers at OTAs. And the value or the quality of the consumer experience in mobile for those OTAs or hotels varies dramatically. And that results in generally an inconsistent conversion pattern across their advertisers. Something that creates a lot of volatility in the marketplace. It creates a bad consumer experience because you can link off and just be left with an awful web experience on a small screen. It is something that Trivago faces. It is something that KAYAK faces, it is something that TripAdvisor is facing.

And one of the solutions is just to go deeper into the funnel to control more of that consumer experience so that you do not have such a drop-off when consumers leave the TripAdvisor site or the Trivago site and go to the OTA or the hotel site. But rather they have a better experience. Over the long term, as people's web experiences get better, who knows whether that will be the long-term solution. But, really, right now it looks like a viable solution for them to solve that consumer problem, which is pretty real.

With respect to hotels participating more directly in Trip Advisor, it is something that Trivago has had for a very long time, allowing small independent hotels to participate in their channel. There have been some intermediaries that have emerged in the industry to help aggregate those hotels' inventory, and allow them to bid more effectively. What I would say about that is, we think it could be a factor. But it is very difficult for small players to compete with big players simply by virtue of the quantity of data that we have, and the quantity of data that you need to be effective in those channels.

So I expect it will be a nice little incremental opportunity for TripAdvisor. We do not view it based upon what we've seen so far at Trivago or other channels as being a significant threat to our business.

**Unidentified Participant** - *Analyst*

One last question? If not, we'll bring the session to a close. There is a breakout immediately after this in Nassau West.

Mark Okerstrom, CFO of Expedia, thank you, Mark.

**Mark Okerstrom** - *Expedia, Inc. - CFO*

Thank you.

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