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EXPE - Expedia Group Inc at Citi Global Technology Conference

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

PRESENTATION

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

Participating in Citi's global tech conference this year, and it's my pleasure to welcome the team from Expedia. Thanks again for participating. Mark Okerstrom, the company's CEO; and Alan Pickerill, company's CFO. And we'll go ahead and dig in. We've got 40 minutes. And we'll save 5, 10 minutes at the end to take questions from the audience, if that's okay?

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

Sounds great, yes.

QUESTIONS AND ANSWERS

Unidentified Analyst

So Mark, I think you're both kind of celebrating your first anniversary here in your new roles. And maybe if you could look back over the last year and talk about some of the priorities that you had set and placed for yourself over the -- for this past year, and maybe give us a bit of a status update on how you think you've done, what kind of progress you've made, and looking forward, how you think those priorities could change a bit?

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

Yes, sure. Well, listen, I think, first of all, it's too early for us to pat ourselves on the back for anything at this point. But we are generally pleased with the progress across the company over the course of the last 12 months. When we took our respected new spots, we articulated 3 key priorities for the company: They were being locally relevant on a global basis, they're being much more consumer-centric, and they're speeding up the pace of innovation and execution across the company. And we've made good progress across all 3 on a locally global business. What this really means is instead of spreading ourselves thin across 90, 100 markets around the world and trying to do everything at one time, it's really about going through and methodically making sure that we've got market-leading products in the markets we choose to operate in with focus. We've got a handful of focus markets. And what this means is making sure that you've got the broadest assortment possible, making sure that when you add new properties or any new products, you've got descriptions and content and photos all translated into local language, making sure you've got the right payments types, making sure that you've got the right landing pages. For example, when you are buying paid search traffic to land the traffic on, and then of course, you're marketing these properties around the world. Like I said, we focus on a handful of countries. We're seeing really good progress there. Last quarter, we talked about seeing accelerating room night growth in those markets. And again, it's early, but very promising. In terms of customer centricity, I mean, this is really all about the fact that in our heart, we are not any sort of traffic arbitrage business. We have automated the function of the traditional travel agent, and we're able to do that in a much more effective way than a traditional travel agent ever had. And customer centricity is all about making sure that we can deliver differentiated experiences to our customers, and we made good progress across the board there as well. A great example is Brand Expedia recently launched a product called the add-on advantage program, which goes very well with their shopping cart functionality, which allows you to book any product, a flight, a car, a hotel, come back to the site or the app at any time before you take your trip and unlock incredible deals. It's great for customers. It's something that's highly differentiated that only Brand Expedia



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can do. And honestly, it's great for our partners, too. We're able to really micro-target customers, fill their hotels, fill their airplanes without doing broad price discounting. And last thing around speeding up the pace of innovation and execution, listen, there's been a lot of things we've done internally around the operational fabric of Expedia Group to get much more focused, much more disciplined, much more metrics-oriented so that we know what we're doing and we're measuring whether it's effective. But beyond that, one of the big pieces that has sped up our execution and innovation has been the migration to the cloud. And not only has that sped up the deployment of code, but it has also allowed us to do things that we were not able to do historically because of the great ability the school of masses of big data compute to run proper machine learning, AI, algos up into the cloud and just action things much more realtime than we were ever able to do before. And that's manifested itself in our performance marketing capabilities and allowed us -- it's been one of the big drivers to allow us to be much more efficient with our marketing spend, which we saw last quarter. So all told, good progress. There's lots left to do. We're in the middle of 2019 planning. Spoiler alert, I wouldn't expect our priorities are going to be dramatically different next year than they were this year.

Unidentified Analyst

Just maybe following on with the cloud comment that you made. I know this is kind of a process that takes every company a while to go through. So maybe you could give us a sense of where you are in that process and have you actually -- you mentioned performance marketing, are there any tangible examples of things that you've been able to do as part of that, that maybe you weren't able to do prior?

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

Well, so we are on a kind of migration process. And really, what this is, is for us, as a tech company, is we are rewriting our code base. And we're writing it to be able to operate essentially hardware-agnostic, allow it to be completely virtualized so that we can truly take advantage of what the cloud has to offer. We have re-factored, I'd say, the -- a large portion of our most critical applications and databases around lodging, around air. We're building up the much stronger muscles in terms of learning and monitoring to make sure that we know exactly how much things are costing us when we deploy code or run algos in the cloud. That's a muscle that, honestly, there's very few players that are operating in the cloud at our scale, with the exception of maybe Amazon, in terms of actually at the e-commerce fabric. And so that's something that we're having to build a lot of tools ourselves. We expect to have the bulk of our lodging business and infrastructure in the cloud by the end of the year, and we'll be moving on to air as well. In terms of a couple of examples, I mean, there were some very early on examples where we had essentially a grayed out situation in our physical data centers on Expedia.com U.S., massive point of sale. We rolled the whole front end up into the cloud with 0 perceived hurt to the customers. It all, in fact, was dramatic improvement. Got things fixed up, rolled it back down. I mentioned that the marketing algorithms, we're building our web apps for mobile as well as our desktop apps. We're building them in Progressive Web Apps, which is going to be native to the cloud. We've got the bulk of Brand Expedia hotel on that right now. It's lightning fast. Not only in the U.S., particularly in places like Singapore and Malaysia where latency, the whole database calls back to the U.S. was -- made it uncompetitive. So the benefits are very significant, and we're pretty pleased with the progress so far.

Unidentified Analyst

Okay. You mentioned marketing. I coincidentally, or maybe not, along with many of the other or several of the other online travel companies, Expedia's been more focused lately on optimizing your marketing spend. Just wonder if you could provide a little bit more context on what you've been doing, why you thought kind of the last year was a good time to be doing that, and kind of where you are in that migration.

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

Yes. Sure. Well, I'll start, and then Alan, you can chime in. I mean, there's 2 things going on here. One is the actions of our competitors create opportunities for us. So in many cases, these auctions have become cooled down and, honestly, just more rational. Secondly is our focus on marketing discipline is something that we focus on very early on. And our capabilities have just expanded. So you've got competitive. You've got capabilities. And on the capabilities front, again, we're looking at really 2 big sources of opportunity. One is just, honestly, just getting rid of non-incremental spend. It's hard for us to see, and obviously, we see a vast amount of the online travel shopping behavior. And we are able to see



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customers and traffic in a market like the U.S., we're seeing a large portion of the shopping activity. And it's hard for us to see much of a situation where someone's shopping for travel and they're not checking Brand Expedia. They're not checking Travelocity, Orbitz or Hotels.com. One of them is going to get a look. And so importantly, we're looking at the spend in our mature markets and saying, "Hey, did the fact that they stopped at TripAdvisor or they stopped at Google along the way, does that mean that, that caused them to make that booking with us, or were they going to do it anyways?" So we're looking at incrementality much more closely than ever before. And then secondly, in terms of new capabilities, again, this ability to process vast amounts of data and match prediction to result with a much shorter time collapse between it is something that is enabled by the cloud. It's enabled us to take algos that were running with distributions that were pretty wide in terms of targeting an average and getting long tails on either side and cutting off the right side of somebody's distributions and reinvesting that money in more efficient spend at high speed using mass amounts of data. And the data science team at Expedia Group is, I think, one of the best in the world.

Unidentified Analyst

And you talked about kind of the typical purchase flow and try to determine how much of it's incremental or not. I assume part of that's just A/B testing. Let's pull some back and see what happens. Have you done that in instances, and then realized that, in fact, you may need to go back into some of these channels? Or have you -- in the vast majority of cases, have you realized that, that wasn't really incremental?

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

Yes, well, why don't you take it, Alan?

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

It's -- I mean, I would say there's cases of both, obviously. I mean, we have a lot of different channels and a lot of different ways of advertising within those channels, and so we can do A/B testing and see where a certain type of advertising is just not incremental or almost entirely not incremental. Other situations, you will decide. Hey, that does look like it's got enough traits of incrementality to it that we would stay in that channel and bid in that channel. But the opportunities have been pretty good to find some -- and you saw that in our P&L. For the second quarter, we had leverage in our selling and marketing line for the first time in a long, long time, for those that have been following the company. And so I think it's proven to be a really good opportunity for us.

Unidentified Analyst

Is this something that had -- sorry, go ahead.

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

I was just going to say, I mean, you said something very important, which is testing, which is we test everything. And it's not just AB, it's ABCDs. I mean, we're constantly testing. And a lot of these performance marketing channels are incredibly dynamic. So not only is the channel themselves making changes to the product, making changes to their traffic sources, but the competitive dynamic is changing, new properties are coming off. So we are constantly testing everything. And our decision around one particular granular traffic stream, whether it's a trivago bid on this hotel out of the Polish point-of-sale is incremental or not, may change tomorrow. And so we're constantly testing.

Unidentified Analyst

How did some of the changes, the evolution of Google's offering in this category, impacted kind of competition in that market, volumes for you guys, kind of ultimately, I guess, also realize it for that channel?



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

Yes, yes. Well, Google has been on a path for many, many years to take what has been relatively modest growing search traffic that's on their channel for travel and essentially get paid more for it. And they've been doing that through shrinking real estate attributable to free traffic, organic search. And they've been doing it through creating products that ultimately deliver better-qualified leads, customers that are closer to the purchase, and they've been doing that by developing products that look a lot like metasearch. Generally, I'd say that Google's an important channel for us, but we have always been very balanced in terms of our marketing mix. And we're much more focused on brand advertising or just have a much broader marketing mix. But Google's still an important channel. And what's been happening in that channel for a long time is that, essentially, it's been becoming less efficient overall. But under the surface though, what has happened is that the metasearch product, again, has been delivering better leads, and that has enabled us to be much more effective in our performance marketing with them. It just means that we've got to be, again, which is core to our priorities, we got to make sure that we are customer-centric, that we create loyal relationships with our customers, because if you don't, then the risk is that more of your business shifts to Google.

Unidentified Analyst

Has it enabled the suppliers though to maybe play a larger role in some of these acquisition channels, or...

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

Not really. I mean, listen, if you look at -- we've obviously got great insight into what's happening in trivago and -- which is one of the largest metasearch channels that exists in the world. And supplier share has been -- it's like nowhere near what the OTAs are. And I think, listen, the issue that exists in these performance marketing channels is that wherever you are bidding, you -- if you're a hotel, you're bidding against players that have a much broader assortment than you and that generally have much more data than you do. And when that's not the case, when you go to these channels, if you're a supplier like they've done in the airline industry with Google Flights, for example, and in some cases, say, hey, we're not going to let anyone else bid on our traffic. What they generally find is that, you know what, Google may actually be a more expensive distribution channel than the OTAs. So I don't think it has necessarily helped or hurt supplier direct. I think the structural advantages of players like us and our competitors who it's their business to do what we do stands pretty strong and remains a competitive advantage.

Unidentified Analyst

I want to move back to something you brought up earlier, it was around the focused international investment strategy and development there. Maybe if you could just level set a little bit of prior to this in country x of 5 or whatever, what did you have in that market? What was kind of the strategy, if there was one there? And what are you trying to build? And how long will that take?

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

Yes. So listen, there was a strategy before. And obviously, I've been in this business for 12 years and has been -- I've been one of the core architects of the strategy before. So I certainly wouldn't [poo poo] it. It was a good strategy for the time, but it's a different one now. What we had been doing was doing a very massive transformation in this business, putting the lodging side of this business. Re-platforming our websites, reducing our hotel margins to get to market-competitive, launching the agency hotel product, building a real business process around onboarding hotels, both with manual labor but in also in automated ways. And while we were doing that, we were -- had algorithms that were essentially saying, what is the next best property to acquire in the world? We go acquire that property. And -- while we were building everything up. And it worked. We had a great run. But the -- what we have observed in our data was that we were gradually, gradually, gradually getting more and more competitive in all of these markets. But because we were doing them in 70 to 90 countries around the world, it's going to take us 20 years to get to a #1 position. And we get it simultaneously out of these markets. Well, that turns out as not the best use of resources, that, in many cases, because we've got a big business, it's easier to get teams and marketing dollars just focused on, guys, let's just all do these handful of markets. And that's really what's spurred the change, which is data suggested that we could be more efficient in marketing spend and head count spend and everything. We could



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be much clearer organizationally around what we're doing and be more simple if we focused on these markets. And that's what we're doing, but we can only do it on the back of this massive transformation that we did the 5 years prior.

Unidentified Analyst

And what were some of the key characteristics when you looked at the 70 countries out there that ended up these 5 kind of floated to the top...

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

Yes. Size of opportunity, ease of us going after it. It's a 2 by 2. We took the top right bucket, and we'll move our way through.

Unidentified Analyst

And what about timing in terms of how -- what are you trying to get to? What's the goal? And how far away is the goal post, I guess?

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

Well, listen, we want to be locally relevant on a global basis. I mean, we're going for everything. And we will look back 10 years from now, and if we do a handful of countries every year, we'll have 50 countries now. And that will be a great business. And so this is -- this isn't a project. This isn't an initiative. This is how we're running the business now.

Unidentified Analyst

And I know one question you guys get often is how much is this going to cost? Is -- or should we expect that every year, there's going to be a significant amount of incremental burn as it's related to this project? I'm sure there's offsetting revenue as well, but maybe talk a little bit about the net investment, how we should be thinking about the net investment in this effort?

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

Yes. I mean, I think I would say, by definition, we're investing as we grow this business on a global basis. And if you think of a market that we're just getting into, that's an investment market. And we will make decisions about allocating capital in that market and building out that market. But part of the way Mark described this is important from a financial perspective because what we -- we have businesses that are large, locally relevant businesses. They have all of the content that they need. They have all of the payment methods. They're localized appropriately. And guess what? They're highly profitable. And you get a lot of repeat traffic, you get a lot of direct traffic, you get people understanding the brand name coming to you directly. And so the idea here is that if you can take -- instead of taking 70 markets and building them out partially every year, you take a handful of focused markets and you spend a year or 2 getting them fully built out, and they start to have the characteristics of these other businesses that we have, then they will start to generate more profitability and you'll be able to use that as reinvestment in some of these additional countries. The other thing I would say that's important from a financial perspective is that it's not just about the handful of countries. It's about a handful of countries where we start to see better KPIs. We start to -- over time, start to see better profitability, and then another handful of countries, and then another handful of countries, and another handful of countries. And if it's working and we're successful and it's working -- and it's building up the way we think it can build out, then that should turn into financial results that are better over time for the whole business.

Unidentified Analyst

What does your share look like among the OTAs in a core market today? And what does it look like in these 5 focused markets? Just to get a sense of how much it of an opportunity, just from a share perspective, that maybe you may have if you can replicate this template that you built out.



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

Well, I would be remiss if I didn't mention the overall market before I even talk about the online segment. It's \$1.6 trillion. And we're the only player that is literally in every segment of it -- air, cruise, car, rail, we're pairing offline travel agents, we're in corporate, we're in leisure, global, and that's what we're focused on. Trailing 12 months, we'll be well north of \$90 billion of gross travel sales. It's a big number, but it's not \$1.6 billion. So we've just got a ton of runway across the board. In markets like the U.S., for example, if you just look at the overall travel market, we are like low double digits. We've still got tons of room, and that's really what we're growing into. And if you look at Smith Travel data, we're low double digits in terms of share of just the lodging business, and we continue to gain share. So if you look at the number I just cited as a U.S. number, that's the potential in all of these other markets around the world. And they are all in low single digits. So we have room for growth that is multiples of our business right now. And we're doing it in an environment where more travel is going from off-line to online; where emerging markets are getting more dollars in their pockets and consumers, when they get more money in their pockets, the first thing they want to do is take a trip; and the technology is getting so much better that it's just easier for them to take a trip because now, they've got their mobile phone, they don't have to wait for broadband access to go to their home. So there's just a great tailwind in this industry. We've got lot of headroom to grow. And we feel good about the new strategy and where it's going to take us.

Unidentified Analyst

Maybe a couple of questions on HomeAway and the alternative space. Bookings growth there was strong last quarter in the 30-something-percent range. But that was down from -- in the 40s a couple of quarters ago. Realize there's a lot of moving parts at HomeAway right now that make it a little complicated just looking at those numbers. But just give us a sense of how we should be thinking about bookings growth at HomeAway over the near- to medium-term?

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

Yes, so you're right to point out it did decelerate in Q2. We talked about it on the call. We did mention that we expected it to decelerate further in the back half of the year. I think the way to think about that though is there's just a couple of components. One is just thinking about the phasing of what we're doing there. We started with a business that was a nice business, but it was essentially an online listings business. And spent the better part of the last 2.5 years basically transitioning that business from that to a true travel e-commerce player. And so there's been a ton of stuff that's happened in transition. As an example, we took on, as we started to take things online, we took on the lower-priced professionally managed properties early. Later, you got the higher-priced, higher-value individual homes. Things like that had an impact on transaction value and transaction size and overall gross bookings. But the way I would look at it in terms of just what's the -- I would go back to what's the opportunity, which is, we think, immense. I mean, we have a business that has focused almost entirely on the U.S., almost entirely on whole home, second homes in primary -- or in vacation destinations. And so we have room to grow in the U.S., we have room to grow in Europe. We have room to grow in all the international markets. We've done nothing really significant in urban markets, and that will be on the agenda as we move forward. And so -- and we think it's an attractive and growing category. So all of those things, we think, add up to a situation where if we execute well, the team executes well, we'll be able to put attractive top line growth rates up for a long time. We know exactly what they are. We're not going to put a pin in. We're not going to guide on that. But we think we can grow this business at very attractive top line rates for a while.

Unidentified Analyst

Whenever you go through a big business model transition, like you guys have there, there's always a risk that your customers, I'm thinking in this case, property managers, homeowners, could -- some portion of them could feel frustrated. I mean, how would you characterize customer satisfaction right now? And what are some of the things maybe you can talk about that?



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

I'd say it's pretty good. Listen, the best metric is if you take a look at when we acquired HomeAway at the end of 2015, I think they had 800,000, maybe 1 million listings, of which maybe 1/4 were online bookable today. They're up to 1.6, 1.7 million online bookable. So -- and we're not trying to acquire the properties. We just get like hundreds of thousands just come to us every quarter. So obviously, the platform is attractive. There have been things though where we have ruled out products or monetization methods for the benefit of the platform that property managers have not liked. When you're a listings business, it is okay to advertise your most beautiful property that has no availability, get a lead, pay for one subscription, have 50 properties and use that as lead, and that works. Great. Fine. Good for you. That's not the business we're running anymore. And so people who are running that type of business didn't like the new way. But importantly, what we've been doing is adding more product functionality that actually allows them to get more value from the platform. So introducing things like recommendations around what you should do with your home to make it more attractive. We're looking, analyzing photos and saying, listen, we see customers in this destination actually have a higher propensity to book properties that have a bathroom displayed that's clean, that is painted with white walls. And we're able to help them actually merchandise the property. We're starting to stream in hotel pricing information and forward demand data to help them price much more intelligently than the 3,000 a week in low season, 5,000 a week in high season, to help them predict when South by Southwest is happening and look what's happening with hotel occupancy and pricing and say, you know what, you could actually yield up and 2x, 3x what your charge is. And that's where the dialogue is changing because at that point, you've got both sides of the platform are engaged. Customers are loving it because it's easy to book, the content is great, they're seeing great inventory. Partners are loving it because they are actually able to run what is a business. I mean, these are small business operators in a way that is more[effective], more profitable. And that's the phase that we're in. That's the phase we want to go to. And I think we're still, honestly, in the early stages of it.

Unidentified Analyst

And Alan, you mentioned next -- one of the elements of the next phase is to build out supply in different segments of the market, urban area. Do you have a sense of how the size of that opportunity kind of compares with where the vacation destinations, and just trying to get a sense of the magnitude of..

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

Yes, I don't. I don't know if...

Unidentified Analyst

Well, maybe another question...

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

I think it's immense.

Unidentified Analyst

So Mark mentioned that you guys haven't invested a lot recently in building supply, it's just sort of been coming to you. As you look to build out your supply and more the urban markets, is that going to require a meaningful amount of investment to do?

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

Yes. I think -- well, I think it could. But I think the issue is that in this business, you have to -- I mean, you're going to need people to do some of this. But you should be able to do it in ways that an increasingly automated. I mean, the ideal circumstance here is that you have very intuitive tools for



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people to use for loading their content, for using this system, for marketing their properties. Maybe in certain circumstances, you've got inside sales teams and you've got support, numbers people can call when they've got questions and things like that. But ideally, you would build tools that are quite intuitive and easy for people to use.

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

Yes. And that's what we've been ultimately doing, not only at HomeAway, but also in our lodging business. We've been moving down to long tail, smaller properties, really getting into a world where hotels or other alternative accommodations on the course via platform are self-onboarding, they're loading content. We're able now, with AI, to be able to score photo quality and create incentives for them to make their content better on our sites. And that's ultimately where we'll go. And I'll just say, listen, on the market size, we don't know how big it is. We've seen reports that say alternative accommodations is \$150 billion, \$160 billion market. I suspect that's understated. If you look at what HomeAway is facilitating, you're in low double digits. If you look at what Airbnb is facilitating, you're in low double digits. I think it's huge. If you look at the number of properties that we've got at HomeAway, call it 1.7 million, you compare it to numbers -- I'm not sure how they calculate them, but bigger numbers that are 4 million, 5 million, we think there's lots of opportunity.

Unidentified Analyst

Got it. Maybe I'll just pause there and see if there are any questions in the audience. There's one over here.

Unidentified Analyst

Can you talk about your Latin America strategy? Is it, I guess, if you look at the -- is it -- if you look at it in your framework of 70 markets, where does it fit in there? Is it a focus for you? Do want to win long-term? If so, what investments are you making today to ensure that?

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

Yes. It's an important market to us. I haven't talked about what our focus markets are. But if you look over the course of the next 3 to 5 years, it's absolutely a market that we're going to want to focus on and get a lot bigger in. Right now, our strategy is really twofold. One is that we have an investment in Despegar, Decolar who's the #1 player in the market. We have that equity exposure, but then we also power a lot of their outbound hotel business. And secondly, we've got the organic opportunity. Brand Expedia is there. Argentina, Brazil, Mexico, Hotels.com is there in the big Latin American markets. And it's -- they're very volatile markets, as you know, but they're important markets. And so we absolutely, just like we do in all major markets around the world, aspire to be a leader in that market. And if we look back 5 years from now, expect we'll have a #1 or #2 position likely in the major markets in Latin America.

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

And I would just add just for a point of clarity. The strategy we talked about and having focused on these handful of markets, doesn't mean that we are ignoring everything else. We've got people and efforts, supply teams in all of these markets. They are continuing to do what they have been doing. I think the focus is much more about capital deployment and making sure it's going into the most important spots. It's about prioritizing effort and focusing workforce. But we are -- we still have plenty of people in Latin America doing important things for the business.

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

Great things. I mean, they're just operating on essentially the old strategy, which is we're -- the people that are there, adding properties were running just well, they're just not getting the big focus.



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Unidentified Analyst

Maybe while we're fielding that one, just a follow-up on HomeAway. One of the real surprises last quarter was how strong the margins were in that business. I realized that quarter-to-quarter, margins can be impacted by rev rec and the timing of marketing spend. But how sustainable is that trajectory of margin expansion that we saw at least during that 3-month window there?

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

Yes, I wouldn't focus on one given quarter for trying to assess the ongoing margins of the business. If you think about Q2, there were a few key factors. We had ramped marketing more aggressively in Q1 this year than we did last year. And so that had an impact on Q2. We were starting to lap over some key investments that we had made in the prior fiscal year. And so there's a lot of things happening in there that impact the margins quarter-to-quarter. I think on a trailing 12-month basis, so we're looking at 2017, I think the EBITDA margins for HomeAway were in the, call it, 20% to 22% range. So I definitely think looking at trailing 12 months or an annual is going to be way more important than looking at a given quarter for the time being. We are -- the team that's running that business and as we kind of move forward with them, we are trying to make sure that we do a good job of investing in the opportunity while still delivering healthy profits or profit growth. And it's kind of -- Mark and I have talked about that before, it's the way we're running the whole business. We think that we're in a position that we can do that, and we will continue to do that. We're not, for HomeAway in particular, we're not focused on a margin level, we're focused on the things we talked about earlier in terms of the global opportunity. But listen, over the long term, can it deliver attractive and improving margins? We think so. But we're not super focused on exactly what that number is at this...

Unidentified Analyst

There is a lot of opportunity though, expanding internationally, growing supply in urban markets, maybe even along with that, marketing. I mean, do you think you can balance that and still show margin expansion in that business? Or are those opportunities just so large and the team is kind of ready to go after them, that you could maybe take...

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

Yes, I mean, I think it's possible. I mean, I think these are things that we're -- we have conversations about this all the time. It's very dynamic, and we're making decisions as we move forward, and we are trying to find that balance. And we do want to make sure that in a kind of a newer and growing market, that we're making the right investments. And that's why we're not highly focused on exactly what that margin is. But could the margin expand over time? Yes.

Unidentified Analyst

So air has been less of a focus. But I think you mentioned that the airlines are finding that Google Flights is a higher cost distribution channel than the OTAs. So I was hoping you could just explain that a little further, particularly as we, I guess, try to think about that as an analog to how the hoteliers might think about the Google Hotel Finder product versus booking through the OTAs?

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

Yes. Well, listen, I don't know exactly what their economics. A lot of this is anecdotal. But the fact is, we know better than anyone that Google's a profit-making venture. And they have a big distribution channel and they extract value from it. So I think that's the larger point. And listen, I think if you talk to the heads of the big hotel chains, I would be surprised if anyone, any of them said that yes, Google's a highly profitable channel for us. That would surprise me.



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Unidentified Analyst

Go ahead. Sorry, right in front here.

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

I'll take that. He's been waiting a while back there.

Unidentified Analyst

Sorry, I've got a couple of questions. Mark, just a couple of questions. If you look out, I guess, 2.5 years as your transition both on the real estate side and also on your AWS transition starts to, I won't say finish, but let's say normalize, is that -- is it unreasonable to then say we should start to see free cash flow? Is there any reason why we shouldn't see free cash flow accelerate at that point in time, A. B, as you're seeing what booking is doing and you're seeing it in their merchant versus agency growth, you can see that a lot their growth now is coming from, in terms of property additions, and even growth is coming from vacation rentals. Is that causing you to think about being more aggressive in these urban markets, which you've said you will focus on, but not in the near term? So is that -- what's the cadence and the rollout on HomeAway for not just doing what you're doing right, but actually expanding that? Is that like 2019, 2020? Like how far out should we think about that? And lastly, can you talk briefly about the new product. It's not so new, but you start to promote it on TV in terms of the shopping cart experience with the new hotel rates that show up?

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

I'll take the second and third of your 2 questions, and Alan will take the first.

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

Yes. So on free cash flow, I think you've -- the short answer is we do think there's an opportunity as we get past the build-out of the headquarters for free cash flow to -- generation to improve. And the one -- you named the main components, which is the new headquarters and the transition to AWS, which we think is cash flow-accretive. The other factor, which you didn't mention, which is also a contributor, is the new tax rate in the U.S. should be a tailwind for us there. There's a bunch of other puts and takes, but the short answer is yes, we think there's an opportunity to see improvement there.

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

And then on just adding lodging properties, putting the alternative accommodations, and then the add-on advantage and shopping cart product. Listen, when it comes to alternative accommodations, the line between conventional, alternative are -- they're blurry. And there's lots of pretty interesting startups out there that are adding urban inventory that looks and smells like a hotel chain, and they're great values. So we're going to continue to expand into that type of inventory. I'd just say that there's a difference between our position and our competitor's position, which is when you've got all of the conventional lodging, the next thing you have to add is the alternative accommodations, which are just generally less profitable. And that's generally where they are because they've been executing on the strategy for a very long time. We are very early days in most markets, with the exception of the U.S., Canada, so we can go through in each of these destinations. And whether it's Paris or London, just start picking up properties, and we will absolutely get to the alternative accommodations and it's just going to be core to our strategy. Now importantly, we've got 2 vehicles for property acquisition. We've got the Expedia team, which is going out and signing up larger ones; and you've got the HomeAway team, which is a lot of self-sign on for individual accommodations. As we get the HomeAway properties properly integrated into Brand Expedia and Hotels.com, we get the user experience to be able to properly allow customers to shop for them and for us to expose them for customer segments who are most likely to buy, that opens up a ton of opportunity. And that's -- listen, we're talking about 2009 or 2019, 2020 time horizon



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when that becomes more of a focus for us and more of a reality. Shopping cart add-on advantage, we, over the course of the last couple of quarters, have expanded add-on advantage, which we -- or shopping cart, which originally we launched for flight and car. Mobile-only, we've actually expanded it into other products and brought it onto desktop. It's being tested in the U.S. I think now, we're 50-50 traffic across all platforms, all products. Super encouraging. I mean, it's a differentiated product. You can drop stuff into it. You see the savings accrue. And it just exposes some of these great product advantages that Brand Expedia has. And yes, we're launching some new product around it called add-on advantage, which highlights the benefit of that, and we're putting some more intelligent television advertising against the 2.

Unidentified Analyst

I think we ran out of time, but I'd like to thank the team at Expedia. Appreciate it.

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

Thank you. Thanks, everyone.

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