MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to Expedia Inc.'s fourth quarter earnings conference call. [Operator Instructions] This conference is being recorded Thursday, February 10, 2011.

I will turn the call over to Mr. Alan Pickerill, Vice President of Investor Relations. Please go ahead, sir.

Alan Pickerill, Vice President, Investor Relations

Thank you. Good afternoon and welcome to Expedia Inc.'s financial results call for the fourth quarter and the full year ended December 31, 2010. I'm pleased to be joined by Dara Khosrowshahi, Expedia's CEO and President; and Michael Adler, our CFO.

The following discussion, including responses to your questions, reflects management's views as of today, February 10, 2011, only. We do not undertake any obligation to update or revise this information.

As always, some of the statements made on today's call are forward looking, typically preceded by words such as we expect, we believe, we anticipate, or similar statements. Please refer to today's press release and the company's filings with the SEC for information about factors which could cause our actual results to differ materially from these forward-looking statements.

You will find reconciliations of non-GAAP measures to the most comparable GAAP measure discussed in our earnings release, which is posted on the company's IR website at Expediainc.com/ir. I encourage you to periodically visit our IR site for important content, including today's earnings release and our updated investor presentation.

Finally, unless otherwise stated, all references to cost of revenue, selling and marketing expense, general and administrative expense, and technology and content expense excludes stock-based compensation. And all comparisons in this call will be against our results for the comparable period of 2009.

And with that, let me turn the call over to Dara.

Dara Khosrowshahi, President and Chief Executive Officer

Thanks, Alan, and thanks to everyone for joining us this afternoon. Overall, 2010 was a solid year with room night growth of 14%, air ticket growth of 11%, and operating income before amortization, or OIBA, growth of 9%. We would have made our low double-digit OIBA growth target excluding certain items that Mike will discuss later. Adjusted earnings per share grew a robust 24% on an improved operating performance, helped by nearly $500 million of share repurchases. While Mike will cover the Q4 financial results in a bit more detail, I would like to cover some of our strategic focus areas.

We believe that we've just touched the surface and have significant potential ahead of us on product improvements resulting from our technology investments. For example, we're seeing great results at Hotels.com, which completed its platform migration roughly a year ago, and has executed quite effectively, driving conversion improvements and substantially higher room night growth in both the U.S. and Europe compared to just half a year ago.

January trends are even better with Hotels.com room night growth in the 30% range, so we're very encouraged by their progress and execution. Our Expedia brand posted mixed results in the quarter and overall grew revenue at roughly the same rate as the third quarter. We just brought in a new President for the division, Scott Durchslag, who was most recently the COO of Skype, and started with us at the beginning of the year.

We are in the midst of significant platform work for the Expedia brand, which we expect to begin to lead to real conversion improvements in roughly six to nine months, similar to the conversion improvements we've already seen at Hotels.com subsequent to their platform work. We've got a good playbook and believe that Scott and his team can effectively execute that playbook for Expedia.

And as we improve our product, we continue to see strong results from our loyalty program at Hotels.com, and are investing in a new program at Expedia. Hotels.com welcomerewards is now well over 2 million members. And we found that these members not only spend more with us, but they also come to us through cheaper marketing channels than our other customers. Expedia.com has now soft-launched its new loyalty program, Expedia Rewards, which allows us to give our members more points, including points for air travel. We view these investments as building moats around our brands and customers in an ever more competitive environment.

Now all of our brands also have significant efforts underway in social media and mobile, as these two channels are exploding and represent significant long-term opportunity for us. Mobile bookings are growing very fast across our brands. An extremely short booking window on these transactions, a very high percentage of which are same-day bookings, suggests to us that they are likely incremental.

We acquired Mobiata, a proven success story in Q4, to accelerate our efforts in mobile. Mobiata is best known for its flight status application, FlightTrack, a top iPhone app for the last two years. And we just last week announced the acquisition of EveryTrail. EveryTrail will be a part of TripAdvisor, and has developed a GPS-enabled publishing platform to create outdoor tours and city guides for mobile devices. The technology will complement TripAdvisor's millions of travel reviews and opinions and enrich the quality of information consumers can access from their smartphones.

TripAdvisor itself had a great year, with annual third-party revenue growth of 48%, and growth in its international business in excess of 100%. Efforts continue in international expansion and in new products. The Hotel Listings product now boasts nearly 25,000 hotel properties, and we've seen strong renewal rates. We're finding that a good number of these hotel customers are smaller, independent boutique properties in Europe who love the product, and nearly a third of whom don't have an existing relationship with an OTA.

In social media, TripAdvisor recently launched its instant personalization efforts on Facebook and has seen tremendous results, recently moving into the number two spot amongst companies using instant personalization with Facebook, just behind Bing. With TripAdvisor leading the way, we believe that over time, our advertising and media business will reach $1 billion in revenue.

Now, looking ahead, our focus remains squarely on building the best travel products and experiences for our travelers all over the world, and tapping into the incredibly explosive new channels such as mobile and social media and into promising regions such as Asia-Pacific and Latin America. We're very encouraged by our early results and are confident that we can earn substantial returns on these opportunities and will not pull back on these investments due to any short-term financial hit that we may see as a result of any near-term events.

I'm happy to cover more details on these initiatives when we get to Q&A. But for now, let me pass it on to Mike.

Michael Adler, Executive Vice President and Chief Financial Officer

Thanks, Dara. Q4 was a solid finish to a good year, albeit lighter on the bottom line than we had planned. We were pleased with revenue growth of 16% in the quarter. Q4 OIBA growth of 7% included an aggregate $10 million for increased occupancy tax settlement reserves and accruals and the net impact of certain accounting adjustments. In addition, we think that the winter storms hurt OIBA by around $5 million for the quarter. Without these items, we would have easily achieved our low double-digit OIBA growth target for the year.

We were also pleased to see revenue margins higher year on year for the first time we took the significant consumer fee actions in 2009. And once again, we generated substantial free cash flow, $622 million for the year.

From a brand perspective, we saw strong performance from Hotels.com, whose Q4 revenue growth accelerated sharply from Q3 as a result of faster room night growth. It's especially encouraging to see the revenue growth for Hotels.com accelerate in each of North America, Europe, and APAC simultaneously.

TripAdvisor continues to post strong results, including third-party international revenue growth of over 80% for the quarter. And even with tougher comps, Egencia continued its excellent performance, with gross bookings growth of 27% and revenue growth of 33%, as our corporate travel brand outshines competitors in helping clients move their travel bookings online and to better manage their travel spend.

From a product perspective, hotel room nights in Q4 grew faster than in Q3 at 15% year on year, continuing the long-term trend of taking share in the lodging market. Both domestic and international grew at a healthy clip and at rates similar to last quarter. Volume was modestly impacted by the severe weather conditions experienced in Q4. Our ADRs were up 2% for the quarter, with flat revenue per room night.

In air, ticket growth was 6% year over year, with a 9% increase in revenue per ticket. In Q4, we accelerated revenue recognition on our merchant air product to the book date, which accounted for roughly two-thirds of the improvement per ticket. This, of course, is a one-time impact, so we do not expect to see similar revenue per ticket growth looking forward.

Since the beginning of the year, we're pleased to have signed new multiyear supplier agreements with US Airways and WestJet.

On the expense side, we accelerated the recognition of certain credit card fee payments. And these along with some other adjustments drove the deleverage in cost of revenue in the quarter. In fact, without these adjustments, cost of revenue would have grown slower than revenue for the quarter and for the full year. I would also note that the customer operations component of cost of revenue grew just 7% in the quarter, showing good leverage.

As far as our financial expectations are concerned, we are expecting mid-single digit OIBA growth for full year 2011. We expect healthy hotel room night growth again, but expect air to be challenged by higher average ticket prices and inventory availability.

Keep in mind, our forecast for 2011 includes significant investments, continuing projects which we began in 2010 as well as new investments beginning in Q1. These investments across technology and marketing are intended to improve our competitive standing and position us well for long-term sustainable growth. They include platform work on Expedia, expansion in APAC and Lat Am, new platforms like social and mobile, and new product offerings like loyalty programs and international Opaque. As a result, for the year we're targeting leverage and cost of revenue and G&A, but expect deleverage in selling and marking and tech and content.

Q1 is seasonally our lowest revenue quarter of the year. With the investments we're making and other near-term headwinds, we expect OIBA in Q1 to be flat to down. More broadly, we're expecting stronger OIBA growth in the second half of the year compared to the growth we'll see in the first half.

As usual, our financial expectations are based on current foreign exchange rates, and any rate fluctuations could have an impact on our actual results.

Our strategic focus has never been better. We're working very hard to make the right investments for the long-term growth of the business, while still delivering solid near-term results. We are extremely energized by the opportunities and challenges we have in front of us.

With that, let's turn to questions. Operator, would you please remind listeners how to ask a question?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Ingrid Chung with Goldman Sachs. Please go ahead.

<Q – Ingrid Chung>: Thanks, good afternoon. I was wondering if you could talk about the Google Places issue. What kind of impact did you see on the business from the removal of the links last quarter? And what could Trip do to offset the risk from Google Places? And just related to that, I guess, how much of TripAdvisor's traffic comes from Google's organic results? Thanks.

<A – Dara Khosrowshahi>: Thanks, Ingrid. As far as how much of TripAdvisor's traffic coming from Google organic results, that's something that for competitive reasons we're not going to talk about. Suffice it to say that the Google channel, both paid and organic, is a very significant channel for TripAdvisor. The TripAdvisor team is – the TripAdvisor content is terrific content, and the review content continues to grow and continues to be fresh. So it shows up very high in the organic results and obviously the TripAdvisor SEM team is also a high performing team. So Google is a very big and important channel for TripAdvisor and will remain a large channel for them.

As far as the specific effect of Google Places, the actual removal of links on Places really has not had that significant an effect on TripAdvisor at all. The traffic that we got or get from Places in general is pretty small relative to our overall traffic. What affects us more is Google favoring Places, its own internal results, so to speak, over organic results. So to the extent that Google is favoring its own results, Places, and automatically putting them on top of organic results, which are called third-party results, as we've seen, that pushes third-party results down. We don't think it's a good consumer experience because clearly consumers do like to look at reviews, et cetera, but that's really the traffic driver. It's not traffic through Places, but it's traffic through the SEO links that's very important for TripAdvisor.

Even with all that, you can definitely see TripAdvisor's revenue growth is still very, very healthy. And we expect click growth in 2011 to be well in excess of 20% plus, and we expect TripAdvisor revenue growth to continue. TripAdvisor has really diversified its source of revenue both in the U.S., but especially internationally. Its international growth is incredibly strong. We're in 27 plus countries and expanding on a monthly basis. And also, we have made very significant investments in building the mobile channels we're in – in any country we're in on the ground. We also include mobile sites. We just released an iPad application, et cetera. And mobile is turning out to be a very significant and quickly growing channel for TripAdvisor.

And social as well, our instant personalization efforts with Facebook are very interesting. And we're increasing the number of people who are personalized on Facebook at a rapid rate, which I think really differentiates TripAdvisor. TripAdvisor used to be just about the wisdom of the crowds. And we're transforming TripAdvisor from not just being the wisdom of the crowds but to also being the wisdom of the crowd and your best friends and knowing where your friends have been and understanding what advice you can get from them.

So these are investments that we made for two, three years. We think we're very well positioned and we see the Google channel growing healthily, and we see these other new channels growing even faster.

<Q – Ingrid Chung>: All right; thanks, Dara.

<A – Dara Khosrowshahi>: Sure.

Operator: Thank you. Our next question comes out of Naved Khan with Jefferies & Company. Please go ahead.

<Q – Naved Khan>: Hi, thanks. It's Naved Khan from Jefferies. Thanks for taking the question. One question on the 30% growth that you mentioned on the hotel side in January, is there something different that you're doing now versus just a quarter back that led to this acceleration, or is it just a ramp up of the effort?

<A – Dara Khosrowshahi>: It really has to do with the platform migration that we've talked about, and it's the same thing that essentially Expedia is going through. Hotels.com in 2009, we reinvested the platform. We combined the European platform and the U.S. platform, and that platform work was really completed in Q1 of 2010. Once we improved the platform and completed that work, we were able to engage in significantly accelerated work on the hotel path on the various pages to innovate and bring in new feature sets, which increased conversion for Hotels.com.

And it's a sequential methodology. You come out with a new feature. You test it. If it works, you roll it out. If it doesn't work, you pull it back. So it's really the amalgamation of, I'd say, the great work that the Hotels.com team has done on site optimization, which has gone throughout 2010, and has added up on top of itself. So when we look at Hotels.com's growth rates in 2010, the first half was not so good. The second half got better. And in 2011, it's really off to a roaring start. And it's really that playbook that I was talking about for Expedia. The Expedia platform is more complex. It has more lines of business, so to speak. But we've seen it work for Hotels.com and there's no reason why it can't work for Expedia as well.

<Q – Naved Khan>: Okay, that's helpful. And secondly, what kind of impact did you see in January from the ticketing issue with American Airlines?

<A – Dara Khosrowshahi>: We're still trying to work that out. I'm not going to specifically talk about partner relationships as they're alive. Obviously, we want to have American Airlines contents on Expedia. We think having maximum content, open content in general on OTAs and on a broad basis on the Internet is great for customers. It's great for us. We think it's great for American. But we've got to work with American on terms that work for us and are fair to our customers, so to speak.

So while certainly American not being on the site will have some short-term impact on our financial results, we still have a great air product. We've got a dynamite hotel product. And we have a business that's very, very diversified, the media streams, the hotel streams, the international revenue coming in. So certainly not a position that we want to be in for a long-term basis, but this is – it's a bump in the road, and we hope that we can come to terms with American that satisfy both sides.

<Q – Naved Khan>: Great, thanks.

Operator: Thank you. Our next question comes from Mark Mahaney with Citigroup. Please go ahead.

<Q – Rohit Kulkarni>: Hi, this is Rohit Kulkarni filling in for Mark, a couple of questions, especially about the mobile app company that you acquired. And you indicated that it accounts for – mobile traffic accounts for 4% of Expedia traffic and bookings grew about [inaudible] year over year. So how similar or different do you think is the monetization rate of traffic on mobile versus regular traffic and how material can mobile become? I just want to get your sense.

<A – Dara Khosrowshahi>: Yes. Honestly, I think it's a pretty speculative question, and my guess is as good as anyone else's. We don't think that there's any reason why mobile traffic can't convert or shouldn't convert as well as web traffic. Today on Expedia, for example, mobile traffic does convert at lower rates as our site, but we think that we can close the gap, so to speak, and we can close the gap quickly. And that, to some extent, is a pretty significant reason why we brought Mobiata in house. It's a small team that thinks mobile, that thinks differently. And already the kind of work that they're doing with the Expedia team is incredibly encouraging as far as radically, radically improving the quality of our mobile products.

So within 2011, we expect to see those benefits. People are coming to the mobile site. And we think that to the extent that we can increase conversion to any place close to the overall site conversion that this can be a channel that's growing even faster. If it's 4% or 5% of our traffic, I think it can get to 10% plus of our traffic within the next 12 to 18 months easily, not only in the U.S. but also abroad as well, but those are wild guesses.

So we're very hopeful of the team coming in. We're working well together with them, and we think that it just jump starts our efforts there and hopefully distinguishes our product above what else you see in the marketplace.

<A – Michael Adler>: I'd point out that Hotels.com mobile is already converting at the same or better rates than it is on the website. Also, when we think of mobile, we also think of tablets and iPads, et cetera. And we're having very early good signs of success there as well. As Dara said, it remains to be seen just how big it can be, but we're very encouraged.

<Q – Rohit Kulkarni>: Okay, thank you. And Mike, can you give a sense of – you talked about investments, in particular Asia-Pacific. So what kind of investments do you think you need to make to fuel your growth for the Asia markets, and how long do you expect to be in investment mode?

<A – Michael Adler>: In Asia-Pacific, we talked about that a bit on our last call. We're going to be expanding Expedia points of sale and Hotels.com points of sale in the region. We're also putting a lot more feet on the ground, particularly in our PSG market management organization. And it's something where we think that in 2011, the investment can really ramp us up for a much more successful 2012. I can't really predict right now how long we're going to be in investment mode. But I think as we go through 2011 and evaluate the returns that we're getting, we'll keep you guys posted.

<A – Dara Khosrowshahi>: And Rohit, just to give you a little bit more color on Asia and the investments there, Hotels.com has a broad basis in Asia, and has the kind of breadth of coverage that we wanted to have. So for Hotels.com, it's a matter of optimizing the site, improving the content, investing in marketing, and expanding. And we're seeing growth rates actually in 2011 that are accelerating over what we saw in 2010. Usually, in these markets as they get bigger, you slow down, but we're seeing actually acceleration with Hotels.com. Some of it has to do with the platform investments that I talked about previously.

Expedia's exposure in Asia-Pacific is a bit more concentrated. It's mostly in Australia, Japan, and India. And what you will see with Expedia in 2011 is a significant acceleration in the points of sale that we actually launch. We launched in Singapore, and expect us to launch in anywhere between five to seven or eight new countries, depending on our technology launch schedule in 2011. So we're pretty excited about that.

And then TripAdvisor has very broad coverage in Asia in general, but we do continue to invest very aggressively in the Chinese market. Daodao and Kuxun, Daodao is essentially TripAdvisor for China, already has the greatest number of reviews in the Chinese markets and growing very quickly. Kuxun is the number two meta-search player there, and we're investing in excess of $10 million in losses a year there, but the Chinese market is worth it. It's a giant market. These sites are top-ten sites. And we think this near-term investment is going to pay off long term in a big way, and we think it puts us in a unique position. We don't think there's any other kind of global OTA out there, travel company out there that's building this kind of a position in China, and we think it's going to pay off and it's going to pay off pretty significantly.

<Q – Rohit Kulkarni>: Okay, great. Thanks, Mike. Thanks, Dara.

<A – Dara Khosrowshahi>: Thank you.

Operator: Thank you. Our next question comes from the line of Justin Post with Bank of America Merrill Lynch. Please go ahead.

<Q – Paul Bieber>: Hi, this is Paul Bieber for Justin Post. Thank you for taking my questions. Going back to Google Places, was the impact on TripAdvisor across all geographies? And then secondly, can you give us a sense of what percentage of hotel bookings are tied to air?

<A – Dara Khosrowshahi>: Sure, as far as the impact on TripAdvisor, it's tough to tell. It was fairly broad. But the international points of sale at TripAdvisor are growing so fast that a slight hit to traffic or the hits to traffic that we saw as a result of Google Places doesn't mean much when you've got growth rates in high double digits, sometimes triple digits. So internationally, we felt it less, and we certainly felt it more in the U.S. Although again, click growth for TripAdvisor we think in 2011 is going to be quite healthy. As far as the percentage of hotel bookings, do you want to talk about that, Mike?

<A – Michael Adler>: Sure. It's not a number that we specifically disclose, but the number of folks that come in and buy a standalone air ticket and then come back to buy a standalone hotel room is fairly low. And it's, again, not a metric that we disclose.

<A – Dara Khosrowshahi>: I think the other side of that, it's certainly the package business for us at Expedia that's a pretty important driver of economics and hotel room nights. And to the extent that air inventory in the package path becomes less optimal, then the hotel – obviously the hotel room nights out of this package, out of the package path will slow down, and we are seeing signs of that in January. But when it gets to standalone hotel room night growth at Expedia, which are at good double-digit rates, those searchers tend to just come in and search for hotels and book hotels.

<Q – Paul Bieber>: How much are the emerging businesses in TripAdvisor contributing right now?

<A – Dara Khosrowshahi>: They're getting bigger and bigger. Again, we don't disclose financials specifically, but I was talking to Steve Kaufer, who is the CEO of TripAdvisor. And he said in January, probably 25% of his traffic came from U.S. IPs. So 75% of TripAdvisor's traffic now is coming from non-U.S. IPs. Obviously, the non-U.S. business is younger. It doesn't monetize as well, but it's a pretty extraordinary number, and it tells you about the long path that TripAdvisor has as far as growth goes.

To give you an idea, again, on the relative monetization, TripAdvisor's revenue, 50%-plus of TripAdvisor's revenue, well over 50% is the U.S. But so much of the traffic is now coming internationally. And we think as the gap between the two narrows, you have pretty extraordinary long-term revenue opportunity.

<Q – Paul Bieber>: Thanks for taking my questions.

<A – Dara Khosrowshahi>: Thanks.

Operator: Thank you. Our next question comes out of Kevin Crissey with UBS. Please go ahead.

<Q – Kevin Crissey>: Thanks for taking my call. When you look at the American business or whatever loss you may have there, does it vary by market? I would think in markets where American is dominant, you may lose more share than, say, a market where they're just a player and maybe there are more alternatives to switch to other airlines. Are you seeing anything on a market-by-market basis that would indicate that?

<A – Dara Khosrowshahi>: Yes, absolutely. There are certain markets, origination markets where American is very strong, and those are the markets where we see our air ticket growth and package volume impacted the most. There is certainly a pretty significant recapture rate that we are seeing, but it's early. And again, we'll be able to tell you more in Q1 as things shape out and we understand the trends.

<Q – Kevin Crissey>: I know you've had some relationships that worked this way. But does your relationship with American – or maybe it's just in general, if you don't want to speak about American. If I'm American, I don't want to pay you very much for a booking from Dallas or maybe from Boston or Miami, but I'm happy for a backhaul market if you fill. Is that how your contracts are structured, such that the economics work that way, or is that a possibility for the next contract?

<A – Dara Khosrowshahi>: I think every contract is different, and there are certain partners – we're certainly open to working with partners on that basis. But every contract is unique. Some of our partners like to pay a flat fee for traffic. Some of them will pay different amounts based on international traffic coming in. And we have tested with certain contracts where partners might pay differently for traffic coming from a hub or non-hub city. The one thing that we have common in all the contracts is we get paid a commission by our partners, and we connect through the GDS. And again, I think if American is willing to work with us the way that 300 other airliners are, we'd certainly be happy to work with them.

<Q – Kevin Crissey>: Okay. And does the US Airways, the new – I guess they're the choice seats, is that coming fully through the GDS? Is that being handled as a fare cost? How are you actually logistically handling that?

<A – Dara Khosrowshahi>: We anticipate that it's going to come through the GDS, and so that's how we think it's going to work. To the extent that they can't make it work through the GDS, we'll figure out an alternative way. I think the point is the end customer experience, right? We've made a deal with US Air. All of their content is in. We want to be able to retail choice seats from them. We'd rather get it through the GDS because that's a very easy way of aggregating content and presenting it, and that's our anticipation for now.

<Q – Kevin Crissey>: Thank you.

<A – Dara Khosrowshahi>: Sure.

Operator: Thank you. Our next question comes out of Doug Anmuth with Barclays Capital. Please go ahead.

<Q – Ronald Josey>: Hi, great, thanks for taking our question. This is Ron Josey calling in for Doug, actually; so two quick questions, the first on marketing costs and another on guidance. On marketing costs, during the quarter we saw costs grow around 20%. I'm wondering if this growth was more from a CPC basis, CPC inflation, or more because of Expedia's focus on entering newer markets; and specifically if there are any comments on CPC inflation domestically versus that in Europe.

And then I've got another question, real quick just on guidance, where I think, Mike, you said we would expect the first half OIBA to be flat to down, second half to see some growth. I'm wondering if that growth is mostly due to investments coming off or just the stronger leisure travel market that's expected. Thank you.

<A – Michael Adler>: On the marketing cost, it is a number of different things. There definitely is some CPC inflation that we're seeing across the business. I don't have domestic versus international breakout for you, but I would say we're definitely seeing that. And we also are continuing to grow faster and expand in international markets, where our marketing efficiency today is still lower than it is in the U.S. And that is part of the reason we're making the investments that we're making in the platform to drive conversion and try and get that more equivalent. So we are, again, spending more on SEM. I think we've mentioned that on prior calls that we've determined that that's an area of the market that there are further opportunities for us to take some more share in.

On guidance, I'm going to restate what you said because I'm not sure it was exactly consistent with what I said in my remarks. For Q1, we expect Q1 to be flat to down. We said that we expect to see the second half of the year grow faster than the first half of the year. There are a number of things going on there. To a large degree, it really has to do with comping some of the investments that we started to make in the second half of 2010. And so we're having much more significant comps in the first half of 2011. It's our more typical pattern to hold technology and content spend flat from Q4 to Q1. This year, we're actually increasing it. So that will also make the comps a bit more difficult. In the second half of the year, we do believe that we'll start to see some of the conversion benefits on Expedia that Dara referred to earlier, and that will also help the business as well.

<Q – Ronald Josey>: Great. Thank you very much, much appreciated.

Operator: Thank you. Our next question comes from the line of Michael Millman with Millman Research Associates. Please go ahead.

<Q – Michael Millman>: Thank you, I guess two related and another one. Could you tell us what percentage of your hotel revenues that are direct connect? And I assume it's pretty high. Why can't that be the case with airlines as well? And could you also – I guess unrelated – tell us what the rental car company supply and pricing has looked like currently and what it looks like over the next several months?

<A – Dara Khosrowshahi>: Sure, Mike. As far as hotel direct connect, the majority of transactions come through I guess what you would call direct connect. There are really two – I'd say three significant systems that we use for hotel connectivity. One is we have a system called ARI, where we connect into the major chain revenue systems electronically. We also have another system where we provide extranet sites for hotels, call it smaller independent hotels to go and update their pricing inventory, et cetera. And then we also connect through the GDS, and those are the three areas. In general, our transactions through the ARI, the electronic connectivity, and through the extranet significantly exceed our transactions through the GDS.

As far as why can't air be the same, I'd point you to a couple of factors. First of all, we built these systems over a number of years on the hotel side. The hotel business is 60%-plus of our revenue. And as a result, we are happy to allocate very significant capital to that side of our business, which is really providing the majority of our revenue. And when we built our merchant hotel product, there really wasn't a connectivity system that could get us what we wanted, which is instantaneous inventory, pricing at the scale that we wanted, so we really had to build it ourselves. If there was a third party offering it the way that we wanted it, we might have picked up that third party. We still use various third parties to help us with our connectivity in various ways.

The other factor that I'd add is that in general, air bookings are much more complex than hotel bookings, as far as getting a specific seat, different fare classes. Pricing is much more variable. And if you want to stay at a hotel in Chicago, that's a pretty simple question. If you want to fly from London to Chicago, there are literally tens of thousands of ways to get there, and that's a much more complex question to ask. So building out, we think hotel direct connect, which we have, is not quite as large a challenge as building out air direct connect. And there are partners who have built out air connect. There are these wonderful switches, terrific technology, and great partners of ours called GDSs. And the vast majority of our air partners are happy to work with us through GDSs. And we think that long term it's a model that has worked, and we think it's a model that will continue to work.

As far as car side, the transaction growth in the quarter was healthy. There was some pricing improvements, I'd say, on slowly improving fleet capacity in the industry. And what we're seeing for the quarter coming forward is that we do expect fleet capacity growth. But what we're hearing from the car companies is that they're going to be fairly cautious on fleet capacity. Obviously, air capacity and the effect of oil prices, et cetera, is going to have some effect on what we see our partners doing. So in general, we see gross bookings, revenue on the car side growing. But we think that revenue per unit, revenue per rental day is probably going to be a headwind in 2011, rather than a tailwind.

<Q – Michael Millman>: When you say price improvement in the quarter that just ended, do you mean that you're getting a lower price, a better price, or the car rental companies are getting a better price?

<A – Dara Khosrowshahi>: I'd say in general, pricing has been stable to up. We have seen a mix shift from higher margin products, so to speak, to lower margin product in general, so that has been a headwind on the revenue side. But in general, pricing has been decent, but I think we do expect some headwinds on car pricing going into 2011.

<Q – Michael Millman>: Okay, and one final question, getting back to the first. ITA, does that offer a reasonable competitive product to the GDS?

<A – Dara Khosrowshahi>: ITA is the dominant pricing system, airline pricing system out there for third parties. So the GDSs offer lots of services, airline hosting products, and actually connectivity. They will allow us to book through tickets, et cetera, agency tickets with our airline partners, and airlines can load in fares, et cetera. ITA at this point provides just third-party pricing. So that if, let's say, I talked about the itinerary from London to Chicago, ITA will find all the different itineraries and try to price the best itinerary out there, similar to an internal product we have called BFS. We have heard that ITA is trying to develop GDS hosting-like functionality, but at least we haven't seen that hit the market yet.

<Q – Michael Millman>: Great, thank you.

<A – Dara Khosrowshahi>: You're welcome.

Operator: Thank you. Our next question comes out of Ross Sandler with RBC Capital Markets. Please go ahead.

<Q – Ross Sandler>: Thanks, guys, can you hear me?

<A – Dara Khosrowshahi>: Yes, we can.

<Q – Ross Sandler>: Sorry, I joined the call a little bit late. I just have two questions. These may be repetitive. First on TripAdvisor, the margin decline that you saw in TripAdvisor, is that solely due to the high margin revenue coming out from the organic traffic you were getting from Google? And should we think about the margin in this business – if we look year over year, should we see the same kind of decline until we comp this quarter next year? Or are there variable costs that you can cut in the TripAdvisor business to get your margins back up, or how do we think about that?

And then the second question is on the guidance. Your hotel revenue has been growing low double digits to teens towards the end of the year. What kind of revenue growth for hotel is baked into the 2011 guidance? And can you just talk about some of the trends in international versus domestic on the guidance for hotel? Thanks.

<A – Michael Adler>: Right. So on your first question on TripAdvisor, our full-year OIBA margin for TripAdvisor was over 53%. And it's actually interesting to note that TripAdvisor has actually expanded its OIBA margin since 2008 while both growing its business and investing pretty significantly.

That said, in Q4, the OIBA margin did drop. It dropped about the same level as the drop that occurred in Q3. Q4 '09 was a particularly tough comp. That's when the business really started rebounding post-recession. And so we don't really attribute the decline in margin very much to what's going on with Google. And really it's more of a reflection of Q4 being seasonally the lowest revenue quarter for TripAdvisor and the investments that we're making.

As we look forward into 2011, we continue to expect a strong top line. I think Dara talked about click growth in the mid-20%. We're seeing growth in revenue from new products, et cetera, but we're going to continue to make the investments in sneak away, vacation rentals, China, mobile, social, et cetera. And those things will impact OIBA margins, and we expect probably several hundred basis points of drop in 2011 to somewhere around 50% level.

In terms of the cost levers for TripAdvisor, there are certain investments that I mentioned earlier that we're making that we could perhaps pull back on if the business grew slower, but we really believe in the long-term potential of those investments. And when you have a business that is as strong as TripAdvisor that has grown as consistently and profitably as TripAdvisor, the last thing that we're going to start to do is prune back on really good investment opportunities because of a near-term situation where we're adjusting to some lower SCO traffic from Google.

So on the second question, and that was on guidance. And in hotel, we are assuming healthy unit growth in our guidance for hotel in 2011. We expect supplier margins to continue to be relatively stable, so that obviously implies good growth in our hotel revenue business in 2011. As between domestic and international, we expect to see the domestic market continue to perform nicely for us. Welcomerewards at Hotels.com is very strong in the U.S. Expedia is doing nicely in the U.S. as well. So we expect to continue to grow in the U.S. and take share.

In international markets, as we indicated earlier, we're going really hard at Asia and really hard at Latin America. So we expect to see much higher growth rates there, and we are already are seeing much higher growth rates. And on Europe, we have really seen a nice rebound at Hotels.com in Europe after the platform work that we did last year, and we're working to get to the same spot with Expedia internationally. So putting it all together, we feel good about the hotel business and its growth prospects for 2011.

<Q – Ross Sandler>: Great, thanks, guys.

Operator: Thank you. Our next question comes out of Herman Leung with Deutsche Bank Securities. Please go ahead.

<Q – Herman Leung>: Thanks, guys, just two quick questions. First, I guess you talked about how TripAdvisor is 50% of revenues, but yet it's only 25% of U.S. IP traffic. Obviously, the U.S. market is very important from a monetization standpoint. And not to beat a dead horse, but a lot of folks have been talking about Google Places, the impact of that. I know you guys have talked about how it hasn't impacted you guys that much, but curious on what you guys are expecting from a U.S. TripAdvisor growth standpoint in 2011.

And then second question I have is on your guidance, you had talked about mid-single digit investment growth. And obviously, that's going to be more front-end loaded from an investment standpoint. I'm curious if you can break down between the costs that you're spending on the core business versus the TripAdvisor business and two or three key investment areas there. And then I have one very quick follow-up.

<A – Dara Khosrowshahi>: Sure, Herman, I'll start with Trip. And just what I'd say is we expect to see – we're not going to get specific, but healthy growth both in the U.S. and internationally as well. Overall TripAdvisor's unique users, I think we're up to 40 million UUs, up 60% over the beginning of the year. Just traffic both in the U.S. and international are growing very fast. We're going to see healthy growth in the U.S., but I won't get more specific than that, and international growth will be well in excess of that.

The note I will make for TripAdvisor again is that the fastest growing part of TripAdvisor international will monetize at a lower rate. But as that monetization approaches the monetization of the U.S., which over the long term it should, we expect to see really great things. And then Mike, do you want to talk about the investments?

<A – Michael Adler>: Sure, as I understood the question, it's really how much of the investments are core business versus TripAdvisor. I would say we've really been investing heavily in TripAdvisor for several years. And we've seen nice returns on, for example, the Business Listings investment. There is some increase in that this year. But I would say the main increase in investment this year really is on Expedia. It's the platform work that we've been discussing during the call. It is really the expansion of Expedia into APAC and Latin America, particularly APAC, where we feel like we are underrepresented. We're also investing in a loyalty platform on Expedia. We've seen the great success that Hotels.com has had with its welcomerewards loyalty platform. And so we've looked at that and said the way to go is to build it ourselves. So we're doing that, and that takes time. It takes effort, and it takes some investment, but we're really confident that we know how to crack these types of nuts.

<Q – Herman Leung>: Got it. And then can you give us a quick comment on how ADR trended in the fourth quarter and maybe in early January between domestic and the European regions for us? Thank you.

<A – Michael Adler>: So on ADRs, we really haven't seen much different in early January than we saw in Q4. And we saw ADRs up modestly in the U.S. and probably trailing a bit internationally.

<A – Dara Khosrowshahi>: Europe's ADRs in dollar terms...

<A – Michael Adler>: Right.

<A – Dara Khosrowshahi>: ...is flattish, while the U.S. is up low single digits. And we expect to see, I would guess, more of the same into January, although I think ADR – some ADR growth for the industry is certainly going to be healthy.

<Q – Herman Leung>: Great, thanks, guys.

<A – Dara Khosrowshahi>: Sure.

Operator: Thank you. Our next question comes out of Mike Olson with Piper Jaffray. Please go ahead.

<Q – Michael Olson>: All right, thanks. I think you've answered this, but when you think about where you're going to put the largest focus internationally in 2011, it sounds like APAC. And then I guess what would be the other geographies following APAC?

<A – Dara Khosrowshahi>: I think APAC obviously number one. China is going to be a fairly substantial piece of it. Latin America and Brazil are very big, attractive markets for Hotels.com that we're investing in. Again, Expedia will be coming in with a stronger presence in Mexico and starting to establish a presence in Brazil as well.

And then the European markets as well; I don't want to, by any means, downplay Europe. You obviously see the size and the richness of the European market with some of our competition, especially Booking.com. And we're seeing really good results out of Hotels.com in Europe. We're introducing the Hotwire Opaque product into Europe as well this year. Expect that as a Q2 event. We think that's a great product that will lend itself to the European consumer who always wants to save money. And then we're going to put considerable effort behind Expedia, which has been trailing somewhat in Europe. And we think some of, again, the Hotels.com playbook as far as driving site conversion with some of this replatforming will work in Europe, just as it has for Hotels.com. So those are the plays we have on hand.

<Q – Michael Olson>: Okay. And then there are a lot of smaller private companies that are doing various components or participate in various verticals that TripAdvisor has some focus in. Do you think that these smaller, more focused sites are gaining any share in some of those verticals served by TripAdvisor? Or maybe said another way, do you think the competitive environment for TripAdvisor has changed at all recently?

<A – Dara Khosrowshahi>: Can you give me an example of one of the private companies you're talking about?

<Q – Michael Olson>: There's a whole host of – I guess you could say, like Uptake, HomeAway, Kayak, companies like that.

<A – Dara Khosrowshahi>: Yes, I think I'd put Kayak and HomeAway in different categories. They're smaller companies but I'd say they're category leaders. HomeAway is a great business in the vacation rentals area. And Kayak, obviously, is a big meta player here. There are lots of meta players in Europe that are very strong. I think in those categories, TripAdvisor actually is the one who is hopefully nipping at their heels and catching up. TripAdvisor has built a really nice vacation rentals product. We bought a company called Holiday Lettings in the UK to establish a market there. And we think other than HomeAway, we think we're the only other company that can build this kind of global subscription base in the vacation rentals product. We're the only ones who have the audience and the ability to bring in reviews, et cetera, into play.

And then on the air meta side, as far as Kayak goes, we've built a nice air meta product in TripAdvisor. Honestly, the economics of that air product are not nearly as good as the economics of the hotel product, but it's a product that our consumers like a lot, and it's a product that we use to attract consumers into the TripAdvisor family and then hopefully upsell them with the hotel product, with reviews, with forums, et cetera. Consumers still search a lot for air product, and we can use that product to upsell them into everything else that TripAdvisor offers. So we have been expanding the breadth of TripAdvisor's product as we expand the size of TripAdvisor's audience, and we love what we see. And we'll keep investing in the new products, in Business Listings as well as international just because of the opportunities out there.

<Q – Michael Olson>: All right, thanks.

<A – Dara Khosrowshahi>: Thank you.

Operator: Thank you and I'm showing no further questions at this time. We'll turn the call back to management for any closing remarks.

Alan Pickerill, Vice President, Investor Relations

Okay, thank you very much. Thanks, everybody, for joining us on the call. Thank you for all the questions. The replay will be available on the IR website shortly after the call. I appreciate your interest in Expedia, and we'll look forward to talking with you again next quarter. Dara, do you have any closing comments?

Dara Khosrowshahi, President and Chief Executive Officer

No, just thank you for joining us on the call. A special thanks to the Expedia Inc. employees for all their efforts in 2010 and looking for bigger and better things for 2011. So thank you.

Operator: Thank you, ladies and gentlemen. This does conclude Expedia Inc.'s fourth quarter earnings conference call. If you would like to listen to a replay of today's conference, please dial 1-800-406-7325, or 303-590-3030, and entering the access code 4403313. We thank you for your participation and you may now disconnect.