MANAGEMENT DISCUSSION SECTION

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Good afternoon. I'm Scott Devitt, Morgan Stanley's Internet Analyst. Have Mike Adler, CFO of Expedia, with us this afternoon. Mike, thanks for joining us.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Great. Thanks for having me.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

I wanted to start just with two kind of top-of-mind items given first, the first capital allocation and the recent pullback in the stock. If you go back in time to 2007, there was a point in time where the company actually thought about a significant recapitalization, actually announced one that in the end ended up being something less than that. And valuation today is that's a more compelling level than it's been in years. You have the capacity to continue to recapitalize the business, so to the extent that you can talk about that, that'd be helpful.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Right. So we expect to continue to be long-term buyers of our stock in terms of how we allocate our capital. We obviously look to share buybacks. We have a dividend for the last year. And then we really look to put our money to work on M&A and investments back in the business.

In terms of any comparability to 2011 to 2007, I would say that there's lots of incomparabilities period-over-period, and again, just reiterate that we continue to believe in the long-term performance of the company and will be net buyers.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Okay. Next question is a Google question and it has two pieces to it. The extent that Google Places has had an effect on your business, which you've discussed on the most recent conference call, and how you think about that threat long-term?

And then secondly, with the Google ITA transaction, potential transaction, how you're thinking about that? What the rational is for being part of the FairSearch.org organization and where you think Google as a threat is more prevalent if it's Places or if it's what they ultimately do with the affect that they can apply?

Michael B. Adler, Chief Financial Officer and Executive Vice President

Okay. So with respect to Google Places, just to make sure that everyone understands it the same way, sometimes enter a search term in Google for hotel in New York, for example. In the organic search results, Google will put in 5 or 10 hotels that will then take you to what they call Google Places. So what Google's doing is they're supplanting organic search. That has the impact on our business such as TripAdvisor as pushing our organic results below the fold, and as we discussed on our last earnings call, that has had a negative impact on TripAdvisor's traffic.

TripAdvisor traffic continues to grow; grows in the U.S., it grows internationally. It is growing slower than we would have expected it to grow absent Google Places. So we still think that TripAdvisor's positioned for strong 2011 and one of the things that remains to be seen is, is the Google Places rollout, is it a one-time impact for us that we then continue to grow upon? Or does Google continue to reinvent and test in ways that perhaps have a bigger detriment for us as a business.

With respect to the Google/ITA acquisition, we're a member of the FairSearch organization that you mentioned, Scott, and for us, the concern is that putting together Google, the dominant search player, with ITA, the dominant air search player, that Google will be able to create an advantage for their own products and services and not really offer a level playing field to companies like us that are competing for traffic for the users who go to Google and do searches. And so there is some commonality between our concern with Google and ITA and what they might do with what they are actually doing with Google Places, again advantaging their own products and services, we think, at the expense of the consumer experience.

So it's difficult for me to step back and say which piece in and of itself may be more impactful to our business, obviously, Google is executing on a strategy across multiple verticals and to the extent at the end of the day that the playing field is fair, we think that we'll continue to do very well. Our concern again is making sure that that a level playing field exists.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Okay. And then before drilling into the businesses, just because increasingly over the years there's been – success has been defined to the extent of your exposure to hotels as a travel company. If you look at this success ratio, the fragmentation of the industry in hotels has been such that being able to exploit that and gain share in the hotel business has led to significant market value. If you could just kind of refresh our memory in terms of the – from a gross profit standpoint, Expedia's business today in terms of the percentage of gross profit that comes from the air business versus hotels versus the rental car business.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Right. So we have about 60%, 60%-plus of our revenue is from hotel and 12%, 13% is from air and 12%, 13% is from advertising. Our hotel business is more profitable. We don't disclose how much more profitable. On the air side of the business, keep in mind that we have standalone air, so you go and you buy a single ticket. But then we also we have a packages product and the packaged product really represents multiple elements in a trip: air, car, hotel, et cetera, and that the latter, the package, is far more profitable for us.

And so air is important to us. It's particularly important to our Expedia business and we expect to continue to make strong efforts there and really try and grow our air business, grow our packaged business and we like the profit attributes in those businesses. I absolutely agree that we want our hotel business to be as big as possible because it is bigger on a profit-per-transaction basis. But again, that's not something that we disclose.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

And so how significant – seems like every three, four, five years, there are rumblings about changes to commission structure in the airline business. Of course, formally, there's no such thing as a commission anymore, but there are certainly ways that OTAs get paid through GDSs and directly from airlines. And so you've had – the dynamics that have popped up recently with American Airlines and some have suggested that that is driven partially by the fact that GDS contracts are coming up for re-negotiation in the near-term. And so to the extent that you can comment on American or if not on American, more broadly about the way you think about GDS contracts and payment stream going forward?

Michael B. Adler, Chief Financial Officer and Executive Vice President

Right, I mean in general, we feel good about our supplier relationships with airlines around the world. Obviously, there's been an issue with American Airlines recently and they're no longer available on our site. They are a partner that we would look to have back on the site, but it needs to be on terms and conditions that we think are good for us and are good for the consumer. With respect to the GDS model, GDS really is a large switch. It connects hundreds of airlines to thousands of travel agents on the other side and it creates a great amount of efficiency and we think that that efficiency really is valuable in helping to control cost to consumers, et cetera. So we think that the GDS remains an important part of the air model for us and so we're going to continue to be supportive of it.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

2011 investments, you've mentioned platform developments, loyalty programs, mobile, social and emerging markets, particularly in Asia, and in prior years you've invested – actually for few years now in platform developments and loyalty programs and those investments seem to be paying off now.

So the first question is can you talk about your investments in platform development, actually how that competitively positions you versus others in the market globally? And what are the investments actually designed to do and what are the proof points that have highlighted your success versus others?

Michael B. Adler, Chief Financial Officer and Executive Vice President

Right. So I guess I'd say we have a bit of a game plan that we've already executed on somewhat and we took the Hotels.com platform which was multiple platforms around the world based on old technology, and beginning in 2009, we began to replatform that business. It launched on the new platform in early 2010 and the business has continued to pick up and gain momentum since then and into January where it's growing hotel room nights around 30%.

So what's driving that? What's driving it is moving from an old platform that's difficult to innovate on to a new platform that's easier to iterate on, easier to test on, easier to adapt the business on. And that has given us significant benefits across Hotels.com. We've seen some similar benefits on our EM platform, that's our affiliates business. Again, we've seen the benefit of again moving from older platforms to new platforms. And we are working on that with respect to Expedia. Expedia is a much more complex business than Hotels.com which is single product. So having air, car, cruise, hotel, et cetera has made it a much more complex process for us.

At the end of the day, what we want to be able to do is be much more flexible, be much more nimble and be much more reactive to what the consumer is telling us that they want or telling us we like purchasing or booking travel this way versus that way and actually being able to implement the changes quicker and have the changes really go all the way through our stack from the front end to the middle to the financial systems. And today, we're a bit of a disadvantage based upon the platform that we're using at Expedia and we are completely dedicated to removing that as a disadvantage.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

As you look at markets like Asia, you have a stake in eLong in China. Was wondering if you could just talk more broadly about Asia specifically, your intentions for growth organically and through acquisition? And then take a step back in your acquisitions philosophy more broadly, are there other segments of the travel markets that look similar to the way the hotel market in Europe did five, six years ago?

Michael B. Adler, Chief Financial Officer and Executive Vice President

So we think Asia represents a huge and important opportunity for us. The size of the market is quite large comparable to Europe. But the online penetration still remains very low. When you actually look at Asia, I think you have to deconstruct it. Country-by-country, what we found and others have found before is India is different than China, different than countries in Southeast Asia, et cetera. And so we're really focused on finding the right opportunities by market. Expedia will be expanding fairly significantly there this year. And in Southeast Asia, TripAdvisor has multiple presences and in Asia, it has a company call Daodao which is a hotel-oriented travel site, and then we have company called Kuxun, which is air meta-search.

So in China, we have TripAdvisor approaching the market from an advertising basis and then we have eLong approaching it from a transactional basis. And eLong has really turned its business around. There's a very large competitor in China, Ctrip, which is the market leader, and our business eLong now has grown faster on the hotel room night front than Ctrip the last two quarters.

I would say if I define the market in China, I would define it as a saying it moves really fast. It moves faster than any market that we've seen and so we continue to kind of adapt our way of doing business and really being open to new ways of doing business in that area.

On your question on M&A, I think you'll likely see us continue to focus on tuck-in acquisitions. We feel like when we look at the business, we have what we need to succeed and succeed well. We will look to perhaps expand geographically through acquisitions. It's not something that we've done a lot of on the transactional side of the business. We have done a lot of it on the advertising side of the business. But I do think that our main focus on M&A will continue to be outside of the United States. I think given the success of our Egencia corporate travel business, that we're also more interested in looking at acquisitions in that space as well.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Okay. You guided for 2011 for mid-single digit OIBA growth and you mentioned that it was going to be driven by healthy hotel room night growth and beyond the rollout – the platform rollout of Hotels.com, is there anything other than economic climate that's driving the hotel room nights?

Michael B. Adler, Chief Financial Officer and Executive Vice President

Yeah. So we expect hotel room nights to again grow at a healthy rate in 2011 and that's really kind of across all geographies for us. And the business is strong. We continue to take share. We think we offer depth and breadth of inventory. We offer the pricing that consumers expect to find.

On the mid single-digit OIBA growth, one point that I want to make everyone clear on is that assumes that American is off the site for the rest of the year. We obviously don't know what the case will be, but with American off the site, higher average ticket prices are impacting ticket volumes. It's impacting our packaged business, and so we are facing headwinds in our air business and we decided that we would move ahead and make the investments that we need to make on the Expedia platform to position us for long-term growth.

We're being very aggressive in Asia and Latin America because we think those opportunities are too big and important for us to not go fast and hard on. We are also investing in social media across the company. TripAdvisor is a shining example of that and they're very tightly integrated now with Facebook. And we're making mobile investments as well across our various brands and what we decided was near-term headwinds on the air business were not going to make us change on the investment side of the business and that we were going to do the things that we really believe are going to result in long-term value to shareholders. And when you put that together, those investments, it – the output of that was our guidance.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

And the take rates with the hotel business, particularly in the U.S., and you anticipate that they've now stabilized going forward? And what's your expectation over the next one to two years?

Michael B. Adler, Chief Financial Officer and Executive Vice President

I mean, we think that we have great relationships with hotels across the world and in the United States. And we think that we're getting paid fairly for the value that we're delivering and we often get the question of agency margins versus merchant margins. And we're really seeing them converge, when you kind of sort out some of noise in the numbers. And we think the real trick is being easy to work with for suppliers and that's what we're dedicating ourselves towards.

Staying in hotels but shifting Europe, very simplistic the belief around the advantage that Priceline, Booking.com has built in Europe has been around an agency model, going in at a very early stage and having a low take rate and then becoming an incremental distribution source for very fragmented, non-flagged hotels and then optimizing SEO, is my own simplistic way of understanding their success in that market.

So if you look back over the last two, three, four years even, the opportunity for Expedia and other competitors in the market to improve in Europe existed. And so where do you think Expedia is now in Europe and what are the dials that you turn to actually gain an advantage and start to shift share in that market?

Michael B. Adler, Chief Financial Officer and Executive Vice President

So Hotels.com is now much better positioned in Europe as a result of its platform changes, and as we said, growing 30% on a worldwide basis, and that includes good growth in Europe for the Hotels.com business. On the Expedia side of the business, we're not where we want to be or where we need to be in Europe, and we're really putting a lot of focus on a couple of different areas.

One is improving the conversion on the site. We think that, that is an area where Booking.com has an advantage with us and that leads to their ability to invest more in SEM. We also think that they have optimized SEM better than we have. They were kind of born as an SEM player; we were born a little bit earlier and focused more on brand advertising, focused more on front-door traffic coming to the site.

Booking.com focused more on what we refer to as sideways traffic into the site. And so we are working to improve our abilities on the SEM site, not just impacting Europe, but that would benefit us in new markets and other markets around the world. So the good news is we've found hotels very willing to work with us in Europe, and we need to get better at feeding the demands into those hotels.

Scott Devitt, Analyst, Morgan Stanley

All right. Shifting back to states for a moment. Do you think – I guess there's been a theory that consolidation amongst the four players could create an opportunity given that such a large percentage of your operating expenses are in sales and marketing expenses, so consolidation actually could provide efficiency with suppliers and from a branding standpoint. And so, you have Orbitz in the public market today, Travelocity in the private market. To an extent that you think there's an opportunity today that's any different than it's been over last three to five years for consolidation and value.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Yeah. I would say we'll continue to be opportunistic in that area. Again, we don't think there's an acquisition that we must do, and any acquisition of that kind is always harder to implement than you might think it is, as well. So again, there's always cases for synergies and then there's also cases for operational complexity. I do think over time we will see some level of consolidation. But we've said that for the last three or four years that there would perhaps be consolidation, but it has not occurred yet.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

In the advertising business then as you look at TripAdvisor and you look at the opportunity for monetization, so beyond traffic growth, incremental branding of that business, just simply site monetization today, do you feel that this side is currently under or over monetized? How do you measure that?

Michael B. Adler, Chief Financial Officer and Executive Vice President

We're careful on that. And I would describe it as appropriately monetized. We really care most about the consumer experience first and that drives everything else. Obviously we're in business to make money. We get feedback from time-to-time and we take the feedback from our customers very seriously. But I think that we have the right balance between monetization and providing the best customer experience.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Is the monetization the same internationally as it is domestically for TripAdvisor today?

Michael B. Adler, Chief Financial Officer and Executive Vice President

The CPCs are much lower internationally and that does potentially provide a long-term opportunity. If we can get the international CPCs higher in the business, we can generate more revenue obviously, but we need to have more competition in those local markets for the clicks.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

And how quickly do you expect TripAdvisor to grow in 2011?

Michael B. Adler, Chief Financial Officer and Executive Vice President

We expect another strong year for TripAdvisor in 2011. We expect click growth of 20 plus percent. We also expect continued revenue growth from its business listings product, which has been quite successful. It has 25,000 subscribers. So that will help drive revenue as well. So again we continue to think that ultimately our advertising business can be a $1 billion business. So again we're quite optimistic on the growth prospects for TripAdvisor.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

So corporate travel, Egencia, you know, corporate travel has been more difficult for OTAs to penetrate. There are, I guess, all kinds of reasons and complexities as to why that's the case. What makes the Egencia asset and Expedia's corporate travel unique and how to the extent that you think you can gain share in that market right now?

Michael B. Adler, Chief Financial Officer and Executive Vice President

It's interesting because I would say we've been quite successful compared to other OTAs. And we grew gross bookings 41% in the last quarter and I think American Express, the key competitor, grew 25%. So we're growing and we're taking share. I would say the idea that an OTA could succeed in corporate travel I think remains and has merit, and we've proven it.

I think our advantage compared to our competitors has been our staying power. We've been in the business and we've been willing to invest in the business for seven or eight years, and I think some of our competitors have flagged from that. And so we think that we just bring, we bring real advantages, we bring internet know-how to the corporate travel business. Businesses that maybe had 5% or 10% of their corporate travel booked online go to 80%, 90% when they switch to Egencia and that drives cost out of the system for them.

So they drive out cost by using Egencia and then Egencia makes available a great range of inventory including special-rate hotel inventory, things that some of the other competitors that don't have a big supply base don't bring to the table. So some of those companies rely more on GDSs for inventory. We've actually gone out and gotten our own. So for us the opportunity remains significant and we remain very committed to it.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

There have been some third-party data services recently that suggested that key word pricing in the travel category has gotten more competitive and more competitive beyond traditional seasonality. So can you comment on that?

Michael B. Adler, Chief Financial Officer and Executive Vice President

Yeah. I would say yes, we're seeing more competition on CPCs. People are looking to optimize SEM. We're looking to do the same and sometimes that ends up helping Google and others. So while at the same time we're focused on SEM and battling against higher CPCs, we're focused on our other channels as well, our direct type-in channels, our loyalty channels, our email channels etcetera, new channels, the social media and mobile to make sure that we continue to grow as well outside of SEM.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Your ability to bundle opaque travel products on the expedia.com path, in terms of your success of doing that, particularly in Hotwire products.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Right, so towards the mid-midpoint of last year into Q3, Q4, we began making available our Hotwire opaque inventory on Expedia, and that is inventory where the visitor or the shopper doesn't know the name of the hotel. They know a general geographic location, but they don't know the name. And they end up getting a good deal, a great deal on the room, and the hotel doesn't disrupt its retail pricing because it's undisclosed until the purchase occurs.

And so last year we put that on the Expedia site, and we've been very satisfied with the results. We really want to offer consumers what they want and how they want it, and we felt it was important to broaden the selection on Expedia. So we're happy with it. It has not driven the overall business significantly, but we've had some good success.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Loyalty programs, you've had a relationship with Citi, I believe, that – around a loyalty program. There has been loyalty related to hotels.com. Seems like that's an interesting opportunity to offset sales and marketing spend over time.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Absolutely, I mean, we're very focused on the loyalty channel. Hotels.com has a program called WelcomeRewards that now has over 2 million members, and an increasing part of the business is coming from that channel. They come back more often, they buy more often, obviously the loyalty program drives that, and it's better economics for us, and it's a good long-term program for our consumers.

We've seen the success of WelcomeRewards, which is our own internal loyalty program. And we compare that to what we were seeing with the ThankYou program on Expedia. And on Expedia we had worked with a third-party partner, and we decided that we could offer more value by replacing that program with our own program. So we announced that recently and have rolled out a beta test of that, but it's something that we expect to put significant backing behind.

When you step back and you say well, why is loyalty important? Or what are we going after? The interesting thing to note is that most people, when they go to buy travel, particularly hotel, are brand agnostic. So if you come to a place like Expedia or hotels.com, you can purchase or book travel across multiple brands, and the advantage of our loyalty program is that you come back to Expedia or hotels.com, you can use it on any airline, any hotel, so that they really are very expansive programs compared to other companies that offer more siloed benefits and so we think it's a real competitive advantage for us.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Any questions from the audience? I had one more which is – to the extent that you interact with investors, yet you must have some perception of what's well understood and misunderstood. What are the one, two, three things that you think are most misunderstood about your business, the realities versus the perception?

Michael B. Adler, Chief Financial Officer and Executive Vice President

I guess the most misunderstood, again perhaps, is whether merchant versus agency is a magic bullet or a silver bullet. We believe that it's about working better with hotels. And we are working with both models and I think some folks maybe don't realize that as well. And so in Europe through our Venere acquisition, we have a significant amount of agency inventory already in house.

In terms of other thing that are not well understood, I would tell you, I'll ask the group whether there's something that's not well understood.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Nothing. They all get it.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Good. They all get it. Thank you.

Scott Devitt, Analyst, Morgan Stanley & Co., Inc.

Well, thanks for your time. I appreciate it. Thank you.

Michael B. Adler, Chief Financial Officer and Executive Vice President

Thank you.