Expedia, Inc.

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Stephen Ju: I'm Stephen Ju from the Credit Suisse Internet Equity Research Team, joined on the stage by Mark Okerstrom, who is the CFO of Expedia. So welcome back.

Mark Okerstrom: Thank you. Great to be here.

Stephen Ju: Happy you're joining us. All right, as those of you in the audience have seen in prior sessions, you can use the Credit Suisse technology app to log questions for us to field here on the stage. So the instructions are there on the screen.

All right, so I'll start off with a few. Let's take a big step back and look at the overall picture here. So when you think about all the different ways the business is changing, whether it's the shift to mobile, increased competition, international traffic, all these various factors, what do you think will be the primary drivers of bookings growth over the next few years? That's a loaded question.

Mark Okerstrom: Yes, great. It's a great question. I think it starts with this is still an absolutely massive industry. It's $1.4 trillion; trailing 12 months, we did about $70 billion of gross bookings. We're the largest player. We're really the only global, full-product OTA.

So where does growth come from? It comes from that extra $1.3 trillion that we don't yet have. And I think what you'll see us do over the course of the next number of years is really grow across multiple vectors. I think one is we're going to continue to expand our international footprint. For better or for worse, we are still a relatively domestically concentrated business, particularly vis a vis the overall travel industry. We want to reverse that trend, and we would love to see two-thirds of our business outside of the US, just like the rest of the travel industry is.

Two, I think you're going to see us continue to expand our product coverage. We recently launched a rail product in the UK, and you're going to see us continue to push along those types of growth vectors as well, in addition to just adding more hotel inventory. There's well over a million hotel properties that exist in the world; we've got 321,000. We've got lots of room to go there.

I think alternative accommodations is something we're incredibly excited about, also a huge part of that $1.4 trillion opportunity that we have not yet fully penetrated into, and we're very excited about the transition that we're doing at HomeAway.

I think mobile, different channels we can penetrate into, I think those all go into the mix as well. I will say, though, that as always, as the overall opportunity changes and we look at making that $70 billion in gross bookings multiples of that over the next number of years, there are investments we've got to make. And we highlighted on our last call the fact that things were going very well at HomeAway, that we would be investing pretty significantly starting here in Q4 and then into 2017, building up big technology and products capabilities, not unlike what we have at Hotels.com, for example, spending more on sales and marketing, really, with the goal to drive to the $350 million adjusted EBITDA target for 2018 that we laid out.

And we also talked a little bit about some of the transitions that we were going to do in our infrastructure, namely a big move to the cloud. And this year we'll spend about $30 million in cloud technology or moving compute to the cloud. Next year, 2017, it's going to be more than double of that. I wouldn't be surprised to see it approaching $100 million. We think that is absolutely the right decision -- to build faster, more scalable infrastructure. We think that it is, in the medium term here, a very free cash flow-positive move. But again, another example of, really, our desire to continue to drive good, solid earnings growth year in and year out, at the same time as making the right investments to sustain that over the long term.

Stephen Ju: Yes. It wouldn't be a fun quarter unless the growth rates were gyrating around because of one thing or another. But over the last couple of quarters, you did see some dips in the room-night growth, and did note on the last quarter print that it improved month on month on month. And I think October was better than September, so exiting the quarter at a high point. The factors that weighed in on the deceleration are now completely well understood, but I'm not quite sure I understand what's driving the improvement there.

Mark Okerstrom: Well, it's the reversal of the bad things --

Stephen Ju: Okay, fair enough

Mark Okerstrom: To make it simple. And there were really two things that drove the deceleration. As you called out, one was network and data center instability. What that does is reduces conversion rates on the website. And when it does that, it not only hurts your room-night growth for that period, but it also retrains your marketing models to bid less. And as a result of that, when you reverse that trend and conversion rates increase, it takes a while to retrain your marketing models to do more. And we were doing that through Q3.

But those issues are behind us. It's really now when do the financial metrics catch up to the booking volume that we're seeing, because we ultimately recognize room-nights on a stayed basis, not a booked basis.

And the other issue was just a diversion of resources away from test and learn feature development towards the Orbitz integration. Those teams are fully deployed back to business as usual. But again, those conversion benefits take a while to flow through, and they take even longer to flow through marketing models, and even longer to flow through room-night stayed metrics. But we feel good about the trajectory that we're on.

Stephen Ju: Got you. You mentioned HomeAway, and I think we asked you this question, almost the exact same question onstage last year. But just wondering if your thinking has changed or evolved. The alternative accommodation players continue to add incremental inventory. Now, inventory is probably growing at a more rapid clip versus travel demand overall.

Mark Okerstrom: Right.

Stephen Ju: So are you seeing any sort of negative impact to pricing in, I guess, the more established hotel businesses? And is there any signs that it's cannibalizing demand? And also, do you feel like consumers are going out of their way to find alternative accommodations?

Mark Okerstrom: Well, listen. I think there's --

Stephen Ju: You are hedged in that regard, to some degree, because you have HomeAway. But just wondering if --

Mark Okerstrom: Yes, listen. I think there's multiple questions in that question. Let me just hit them off in some semblance of order. I think one is there is a broad, growing interest in alternative accommodations, generally. We do see lots of research to suggest that more and more alternative accommodations are becoming, at least in the consideration set, for consumers. So we think as a category, it's outstripping the overall travel market.

Whether it is incremental or whether it's cannibalistic to hotel, it's a bit too early to tell. I think the answer is probably both, which is when I think about alternative accommodations, there's a lot of the people that are staying in alternative accommodations are looking at, "Do I stay at this HomeAway property for 30 days, or do I stay at this corporate housing option that I have?" for example. Increasingly, that's becoming a tradeoff. That corporate housing business was never really our business. It was never any business of the chain.

So there's certain parts of it we think are absolutely incremental. We think some people, for example, are choosing not to stay with Grandma, but to take the great deal of the HomeAway place, just because there's more awareness of it. But certainly, there is some places in the lodging industry where I think it will be cannibalistic. I think the low-end budget area, I think, is particularly at risk. The alternative accommodation value proposition is pretty darn good in that category.

As far as what we're actually seeing, data that I can speak to, we don't see any weakness in hotel demand when we look at our -- our overall booking trends continue to be incredibly robust. Conversion continues to increase. We look at the marketing channels for hotel like trivago, like Google, continue to grow at a very robust pace. So demand is there, and consumers, when we acquire that demand, are still buying hotels very happily on our sites.

What we do see -- and you raised this question around pricing power -- again, we have called this out a couple of years ago. This year, in Dreamforce in San Francisco -- again, this is a market which would traditionally sell out -- there was a lot of Airbnb inventory available in San Francisco for Dreamforce, and there was certainly buzz about it, too. People were talking about it. We did see significantly more inventory come through on the hotel side than we would have otherwise seen, and we saw some great prices in our room -- hotel room-night growth was incredibly robust around that period. And if you'd have backed up three years ago, sold-out, prices super-high. So far, it's been great for our business, but there's definitely some impact there.

Stephen Ju: Okay, got you. Another hot topic du jour -- Expedia's new partnership with Red Lion this year. Has the relationship between the OTAs and the hotel chains been really changing that much? Do you think there will be changes going forward?

Mark Okerstrom: Well, I think the position that some of the larger chains have taken, both in the popular media and press and also in terms of their consumer messaging, has changed. Certainly more messaging around book direct, don't click around, offering lower rates to consumers if they sign up for the loyalty program and book on the direct sites. These are things that are generally new.

That said, we have not seen an impact on our business. I think we have been incredibly resilient, and what's happened in our channel is that the hotels that ultimately don't give our consumers the best rates, their peer set is happy to do that, and we find that consumers are substituting out of that product into a different alternative. And that's been fine for us.

So I do think the tone has changed, but it's been more tonal than real impact to our business. And listen, we're very hopeful that we can continue to have a long, constructive relationship with all of these big chains. I think the fact of the matter is, is we're just in different businesses. We're a technology company that offers, right now, 321,000 properties around the world. I think the biggest chain has maybe 7,000 or 8,000 properties, and they operate in market hotels. It's just a different business, and I think that we have a lot that we can offer these partners of ours.

The Red Lion example, where we are offering customers who would like to stay in a Red Lion the opportunity to get discounted rates as long as they sign up for the Red Lion Loyalty Program, I think, is a great example of one of those things. We are helping Marriott with their vacation packages business, where we're powering vacation packages, bundling Marriott hotels with flights for incredible deals. I think that's another example.

And we're very optimistic that aside from this current real push that has had some counter-OTA tones to it, which we hope mellows out over time, we think there is lots of opportunity for a broad and fruitful relationship with the big chains and small chains and medium-sized chains for a long time to come.

Stephen Ju: Got you. Update us on the international opportunity, your improvements there in recent years, particularly, I guess, the rising demand out of China.

Mark Okerstrom: Well, as you know, we made a pretty big move in China last year, which was to divest ourselves of our majority position in eLong. With that, we really stepped away from the domestic Chinese market, but we're very much still engaged in, and interested in, and thriving in the outbound Chinese market.

Largely, we've been doing that through partnerships. We power a lot of the big players in China, both traditional travel agents and corporates, as well as a lot of the big online travel agencies as well, with our global inventory. We do have -- Hotels.com has been operating in China for a very long time, again, predominantly in outbound business. We launched Expedia China last year as well; again, predominantly an outbound business.

So we're taking a different tact in China than, certainly, we were three years ago. But we remain very optimistic about particularly the outbound business and how big that can be for us for a long time to come, because China's a big market and it's only going to get bigger. And I think we're optimistic that over a long period of time, we'll be able to build a meaningful domestic presence there as well.

Stephen Ju: Yes. What did you make about Ctrip's acquisition of Skyscanner? Do you think this is move number one from, I guess, a strategic perspective for them to go out and build out their own supply base to match up versus their demand that they have?

Mark Okerstrom: Well, I don't know about move number one. It's probably move number three or four for them. I think, firstly, is we have an incredible amount of respect for the Ctrip team. We think it's a great business. We think it's incredibly well managed. And we think that the moves that they make generally just make a lot of sense.

They've been expanding their hotel supply footprint to meet that China demand throughout Asia for a long time to come. They took a minority interest in MakeMyTrip in India pretty recently. They've made a few acquisitions in and around the greater China region, and now this Skyscanner acquisition. I think, again, it's a business that has got a lot of growth potential, and one where making acquisitions to further expand their opportunity, that makes sense. I think Skyscanner fits in with that quite nicely.

Stephen Ju: I think at this point we can open it up to the floor for a question, if any. And as a reminder, you can also submit your questions anonymously through the CS Technology Conference app.

Mark Okerstrom: We've had a very shy audience. I want to get the Expedia team to look at the UI of that app. (Laughter) I think there's a question in the back there.

Unidentified Audience Member: Just curious on your thoughts around Google's ambitions within travel. I know they've been on the periphery, and you guys pay them, as well as Priceline, pay them a lot of money every year. Just curious how that relationship, you see it changing over time, because they sure would love to have the information that you have about traveler preferences, et cetera. Thanks.

Mark Okerstrom: Yes, I think it continues along the similar vein that it has for the last number of years. Their ambitions in travel, really, I think, got serious with their acquisition of ITA Software a number of years back, which was really the basis for their Google Flights product. And I think there was a lot of speculation at that point around how far would they go. Would they want to become an online travel agency or not?

Since that time, we have seen them continue to make their advertising products better, and better qualify their leads in the hotel business, continue to make their Flights product better, continue to shrink free traffic and substitute it for paid traffic as well. And we think that they will continue to do the same.

I don't think that they have much, if any, interest in hiring 12,000 multilingual call center agents around the world or another 4,000 or 5,000 people to develop relationships with 500,000 independent hotels around the world. I think their incentives are to make the most money they can and grab the largest profit pool they can out of the travel industry. And I think for them right now, it remains -- that opportunity is in the advertising business.

So I think, again, we'll see a similar trend, which is shift more free to paid, make the paid traffic more highly qualified, and that will entitle them to a larger portion of the profit pool. We don't see them as really moving into the OTA space. But we are very watchful of them, because they're a large and powerful force.

Stephen Ju: I'll press on with another question. Let's talk about the other large operator in the space. You've been testing your Facebook Messenger bot. Can you talk a little bit more about the long-term opportunity there, and especially in artificial intelligence? And how integrated can that be in the overall product, and how long until we see some sort of an impact on the interface?

Mark Okerstrom: Well, it's certainly topic du jour -- AI, voice, chatbots. I think about voice and AI as two separate things. I think, on the chatbots/voice opportunity, listen, I think that transacting via chat is a little bit clunky when you actually have to chat out your chat. And most of the things that we see is it starts there and then ends in a more traditional structured query that is handled in a more traditional way.

When you extend that up to voice, though, I think that's something that's a little bit more interesting, from our perspective, and interesting in the sense that we don't think that we are ever going to be as good as Google, as good as Facebook, as good as Amazon, as good as Microsoft or Apple, in translating language, natural language, into structured queries. But we do think that we will be the best at taking the structured queries that get translated, which could be something like, "I want to go to a sunny place in the South Pacific next weekend," and being able to deliver flight, car, hotel, pricing, and package inventory alternatives better than anyone else in this industry.

In a world where we move to more voice, where we are the best place to deliver that answer, and in a place where in voice it's not just Google and search any more -- it's Amazon, it's Apple, it's Facebook -- and there's more fragmentation in the top of the funnel, that's actually probably a good thing for us. More advantage in answering the questions and delivering the data against more fragmented search demand. That could be an opportunity for us.

Stephen Ju: A curious point that you bring up, I think, in being able to serve the query, "I want to go to a sunny place," better versus your competition. I think you still maintain a presence in all the other different modes of travel that people need. So is the game here to be the one-stop shop, to give the complete intermodal travel experience, whether it's the car to the airport, whether it's the rail, whether it's the flight itself, hotels, activities, everything all in one place?

Mark Okerstrom: Yes, listen, absolutely. That has been the strategic aim of brand Expedia for a very long time, and I think that we are still in the early innings of all the possibilities there. I think if you just look at flight, car, hotel, activities, we're doing a reasonably good job there, certainly on a standalone basis. But we're still at the very early innings of being able to drag and drop into a shopping cart, for example, and start to see package savings materialize when you bundle these things together, and then things like car to the airport and other in-destination opportunities -- rail -- we're just much, much earlier on. But absolutely, that's the place we're going.

Stephen Ju: Got you. There was a question back there.

Unidentified Audience Member: Two quick questions. One is you had a stumble mid-year. It looked like you got your footing back during Q3. You indicated bookings were improving. How do you gauge if that was a sustainable recovery or just, for lack of a better term, a dead-cat bounce? And the other is, if you could just touch on your strategy for monetizing some of the pieces of the Company where the Ctrip, like how you're thinking about that in broader context.

Mark Okerstrom: Sure. So just so I'm clear, the second question, just before we lose the mike, was around monetizing some of the other businesses that we have beyond the core OTA business, like a trivago, HomeAway, et cetera? Got it.

So first of all on the room-night growth recovery, we do think that the trends that we were seeing in the third quarter, which is absolutely re-accelerating room-night growth, is sustainable. And the reason that we believe it's sustainable is, as I kicked off with, this would just be reversal of some issues that we could directly attribute the slowdown to. And we are back to execution, business as usual, and the results that we're seeing is the results of business as usual, are consistent with the results that we have historically seen. So it makes us feel pretty confident about the direction that we're heading.

Listen, in terms of the way that we monetize all of the different pieces of the business, I think that we've made no secret, and there's been a recent filing for trivago, which is pursuing an initial public offering. I think that's one example of how we can at least shed a light on some of the value in the portfolio. And I think, as always, we are in the business of creating shareholder value.

And with all of our assets, we're really looking at how do we best monetize this? How do we best create shareholder value, either by keeping all of the business within the Expedia, Inc., umbrella; by selling a piece of it out, like we're doing in the case of trivago; like spinning off TripAdvisor in a tax-free spin like we did. I mean, we're always looking for ways to create shareholder value. We don't have any initial plans right now to do anything other than what we're doing with trivago, but we're always open-minded to those types of things.

Stephen Ju: Got it. In terms of additional M&A opportunities, you've been adding supply; you've been adding demand here and there. Is there a particular focus? Does it have to be either/or at this point?

Mark Okerstrom: I don't think in terms of supply versus demand, there's a particular trade-off. I mean, really, the best businesses are ones that have created a network effect flywheel between the two, to be honest. And certainly, that's what we see with a business like trivago. That's what we see with our core OTA businesses, for example, and the businesses that we have built up over time.

I think that the one place where we did focus on demand side was really this OTA roll-up that we did with Orbitz and Travelocity and Wotif. I think there's possibility that there could be other opportunities in this space, but right now, we're pretty focused on optimizing what we've got. But listen, our appetite for M&A remains strong, and as always, we'll be opportunistic.

Stephen Ju: Got you. And with that, I think we are out of time. Thanks very much.

Mark Okerstrom: Great, thank you. Good to see you.