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PRESENTATION

Operator

Good day, and welcome to the Expedia Group, Inc. Q3 2019 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Michael Senno, Vice President of Investor Relations. Please go ahead.

Michael Senno - *Expedia Group, Inc. - VP of IR*

Good afternoon, and welcome to Expedia Group's financial results conference call for the third quarter ended September 30, 2019. I'm pleased to be joined on the call today by Mark Okerstrom, Expedia Group's CEO and President; and Alan Pickerill, our CFO.

The following discussion, including responses to your questions, reflects management's views as of today, November 6, 2019, 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, we are optimistic or confident that or similar statements. Please refer to today's earnings 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'll find reconciliations of non-GAAP measures to the most comparable GAAP measures discussed today in our earnings release, which is posted on the company's Investor Relations website, ir.expediagroup.com. And I encourage you to periodically visit our IR website for other important content, including today's earnings release.

Unless otherwise stated, all references to cost of revenue, selling and marketing expense, general and administrative expense and technology and content expense exclude stock-based compensation and depreciation expense, and all comparisons on this call will be against our results for the comparable period of 2018.

A reconciliation of adjusted EBITDA guidance to the closest corresponding GAAP measure is not provided because we are unable to predict the ultimate outcome of certain significant items without unreasonable efforts. These items include, but are not limited to, foreign exchange, returns on investment spending and acquisition-related restructuring expenses. As such, the items that are excluded from our non-GAAP guidance are uncertain, depend on various factors and could have a material impact on GAAP results for the guidance period.

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

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

Thanks, Michael. Although room night growth was in a healthy range in Q3, adjusted EBITDA was lower than we expected, primarily due to a few key factors. We saw incremental weakness in SEO volumes and a related shift to high-cost marketing channels. We saw lower average daily rates than we expected, which weighed on our lodging results, and profit was softer than expected at trivago and Vrbo. The majority of the ADR impact was in North America, which slowed more than we anticipated, while ADRs also came in light in Asia due to negative macro and geopolitical events. We expect the softer local currency ADR environment and mix shift to high-cost marketing channels to continue to have an impact over at least the next few quarters.

As discussed on their call yesterday, trivago saw volatility in their marketplace related to new advertiser features they introduced. That contributed to lower-than-expected revenue and a significant year-over-year decline in Q3 adjusted EBITDA. Gross booking and room night trends at Vrbo also remained muted, and we incurred additional costs related to our payment processing migration. As a result, we have reduced our 2019 profit expectations for both trivago and Vrbo.

Given our third quarter results and the expectation for continued impact from the factors we experienced in Q3, we are lowering our full year 2019 guidance for adjusted EBITDA growth to 5% to 8%. Over the past several months, we've been in the process of realigning teams across the organization. And over time, we expect these changes to improve our operational efficiency and effectiveness. That said, with many people focused on that effort, it did likely impact our ability to anticipate and react to the dynamics we saw during the quarter.

In terms of the changes we've made, we brought several customer-facing functions closer together to help us collaborate more effectively and scale our international expansion efforts. We brought supplier-facing teams closer together to better serve our travel partners and realign many of our tech and product teams to drive increased collaboration, innovation and scale. These changes position us to drive better top and bottom line growth over the long term.

And though it will take time to realize the full benefits of this effort, the teams are eager to begin driving improvements. In spite of the disappointing results, we saw several positives in the quarter. Volume trends in Q3 were solid as we delivered an 11% increase in total stayed room nights, led by healthy 12% room night growth in our Core OTA segment. Domestic room night growth accelerated in Core OTA, and we continue to gain share in the U.S. Our execution on supply acquisition remains solid as we added, again, over 40,000 properties to our core lodging platform in Q3.

We also increased the number of integrated Vrbo listings to over 650,000. And in total, we ended the quarter with more than 1.4 million listings on our core lodging platform. We're seeing progress on our initiatives to increase customer centricity and local relevancy, which are aimed at building customer loyalty and increasing our direct business.

In total, the direct channels at our OTA brands are growing faster than the overall business, led by strong growth in mobile app. Expedia Partner Solutions continues to deliver solid results, is also growing room nights ahead of the overall business. Our recent agreement to become Marriott's exclusive optimized wholesale distributor is a great example of the power of our platform and technological capabilities, and we see a long runway of opportunity at our Partner Solutions business going forward.

And Egencia had a healthy quarter of new client signings and delivered double-digit room night growth as it benefits from increasing hotel attach rates. Although we're disappointed with our results in the third quarter, we understand the near-term challenges and are actively working to navigate them. At the same time, we're encouraged with our progress in many areas and are optimistic that we can further build on those trends as we execute on our key strategic themes: being customer centric, being locally relevant on a global basis and unlocking the full power of our global platform. Despite near-term pressures, we remain confident that this strategy will position Expedia Group to capitalize on the significant opportunity ahead of us, leading to healthy growth and attractive returns over the long term.

With that, I'll turn it over to Alan.

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

Thanks, Mark. In Q3, we increased both gross bookings and revenue 9%. Total lodging revenue growth was 11%, in line with stayed room night growth. But given the factors Mark discussed, in addition to the headwinds we previously mentioned for the quarter, our adjusted EBITDA was flat in Q3.

At Vrbo, gross bookings increased 5% in the quarter. Revenue was up a solid 14% driven by approximately 20% growth in transactional revenue, which represented more than 90% of Vrbo's revenue for the first time. Revenue growth was partly offset by continued investments in both performance and brand marketing to support the Vrbo brand and higher payment processing costs as Vrbo accelerated the shift to Expedia Group's payment platform. As a result, adjusted EBITDA for Vrbo increased just 3% in the quarter. We expect a similar dynamic in Q4 with higher marketing investments as we head into the peak booking season and additional costs related to payment processing putting pressure on adjusted EBITDA.

Total advertising and media revenue grew 3% year-over-year and was up 6%, excluding the impact of foreign currency. Similar to the past few quarters, revenue declines at trivago were more than offset by strong 18% growth at our Media Solutions business. Looking ahead, we see a nice runway of growth for Media Solutions as we increasingly leverage the reach of our global platform.

Air revenue declined 3% in Q3 with lower revenue per ticket, partly offset by solid growth in tickets sold. Revenue per ticket was down 10%, largely reflecting a reclassification of certain fees to other revenue in addition to a shift in product mix and FX headwinds. That was partly offset by 8% ticket volume growth as we continue to benefit from new enterprise partnerships at Expedia Partner Solutions.

Turning to expenses. Cost of revenue grew 14%. Cloud expenses contributed 500 basis points to growth as we migrate more compute to the cloud. The inorganic addition of Bodybuilding.com, which we acquired in the Liberty transaction, added over 400 basis points to growth, although it did not have a meaningful impact on adjusted EBITDA in Q3.

In addition, the French digital services tax contributed nearly 300 basis points to cost of revenue growth as we recognized the full year-to-date amount since the tax was retroactive to the beginning of the year. Because of the addition of Bodybuilding.com and the digital services tax, we now expect cost of revenue to grow faster than revenue for the full year.

It's worth noting that the global tax environment is rapidly evolving, and several other countries are currently considering adding transactional-level taxes. It's still too early to know the specific implications, but we are continuing to closely monitor these developments.

Total selling and marketing expense grew 11% with direct selling and marketing up 14%. The increase in direct selling and marketing was due to partner commissions at Expedia Partner Solutions related to growth in that business and higher investments in both brand and performance marketing, in part because of the shift into high-cost marketing channels we mentioned earlier.

Indirect selling and marketing declined 5%, reflecting a reclassification of certain expenses to technology and content and lower people-related costs along with declines at trivago. Technology and content cost growth was essentially in line with revenue for the quarter. Cloud expenses contributed approximately 250 basis points to growth. We continue to expect technology and content expenses to deleverage for the full year.

In terms of our cloud migration, we continue to progress as planned. We are on track to largely complete the lodging stack by the end of this year and expect to be positioned to complete the air migration next year as well as push further on our other products and back-end systems. We expect 2019 cloud cost to come in slightly lower than $250 million. We are still completing the planning for 2020. But based on what we know at this point, we anticipate cloud expenses to be in the neighborhood of $350 million next year.

General and administrative expenses increased 8% year-over-year, largely due to higher professional fees and approximately 150 basis points of inorganic impact from Bodybuilding.com.

Looking below the line, depreciation expense growth remains muted, increasing just 3% as we continue to benefit from the lower data center CapEx over the past few years. Adjusted net interest expense decreased year-over-year while our adjusted tax rate increased to 25% in Q3, which resulted in adjusted EPS declining 7% year-over-year.

Year-to-date through Q3, excluding CapEx investments for our new headquarters, free cash flow increased a solid 15%. In the third quarter, free cash flow decreased more than usual due to a shift in the timing of certain payables and the comparison to settlement payments received last year. The balance of the change in Q3 related to supplier payments for merchant bookings from the first half of the year given the normal seasonality of our business. Looking ahead, we see an opportunity to drive further improvement in cash flow conversion over time.

Turning to the balance sheet. We took advantage of favorable market conditions to issue a $1.25 billion 10-year note with a 3.25% coupon. Our approach to managing the balance sheet is unchanged, and we continue to operate within an investment-grade credit rating. In addition, during the quarter, we redeemed the $400 million convertible notes that we held following the Liberty Expedia deal.

On the capital allocation front, we resumed share repurchases following the completion of the Liberty Expedia deal, repurchasing $418 million in stock since Q2 earnings. Together with the Liberty Expedia transaction, we are pleased to have brought in a total of 6.3 million shares so far this year.

Moving to our financial expectations for 2019. As Mark noted earlier, our updated guidance of 5% to 8% adjusted EBITDA growth reflects the mix shift into high-cost channels and the lower-than-expected ADRs, both of which we expect to continue to play a role over the next few quarters. In addition, we now expect lower full year 2019 contributions from Vrbo and trivago.

Overall, we are not satisfied with our results, and we'll continue to navigate these changes over the coming quarters. We do, however, remain confident that executing our strategy will strengthen Expedia Group's position in the market and lead to share gains and healthy growth over the long term.

Operator, we're ready to take our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from Lloyd Walmsley with Deutsche Bank.

Lloyd Wharton Walmsley - *Deutsche Bank AG, Research Division - Research Analyst*

A couple, if I can. First, just on the SEO challenges, can you maybe give us a sense of which brands or which geos or maybe which Google products are causing the most disruption? Any color you can give us there would be helpful. And I guess, as a follow-up, specifically looking at the vacation rental category and Google moving to kind of mimic what they did in hotel with vacation rental, wondering, does your strong presence in their new unit, their metasearch unit offset some of the SEO challenges from moving kind of organic links down the page? And when Google -- what do you expect in terms of the time line for Google starting to charge for that product and kind of what kind of impact could we expect from that?

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

Thanks, Lloyd. So the SEO challenges were, I would say, things that we saw across multiple product categories. They were things that, in some cases, we saw across multiple regions. So the impact was -- is really something we felt a little bit more broadly across our multiline of business brand than we did lodging-specific brands. And generally, what we saw was a continued shift of essentially the freed links further down the page by other modules that were inserted and ultimately a shift of traffic from the SEO channel over to some of the other products, whether it's flight metasearch or hotel metasearch over time.

Now of course, as it related to the hotel product, the lodging product, we were able to pick up some of that volume, and that ultimately resulted in us spending more on sales and marketing than we otherwise would have. We're happy with the returns that we saw on it but ultimately not as good returns as we would see from the SEO channel.

With respect to the VR category, right now, it's pretty small. And it's something that we are actively looking at in terms of evaluating that product and looking at whether it's something that we think is going to be a good thing for us over the long term or not. But right now, it's still pretty small.

Operator

Our next question comes from Mark Mahaney, RBC Capital Markets.

Mark Stephen F. Mahaney - *RBC Capital Markets, Research Division - MD and Analyst*

A little more color, please, behind the lower ADR trends in Asia. Is that just -- a lot of that is just political turbulence around Hong Kong, but any other color there? And then any update on the ability to diversify more into social marketing channels, Facebook and the like, and whether there's possible -- there are any improvements there? Are you seeing the ability to tap into commercial intent? Or is that still far away?

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

Yes. Mark, this is Alan. So on your first question on the ADRs. I would just say a few things as you dissect those numbers. First is on a reported basis, the ADRs we're reporting are pretty consistent through the year. The key there is that the foreign currency impact was much more of a negative in the first half and much less of a negative in the back half year. And so that kind of masks the actual kind of decline we're seeing in terms of local currency.

Relative to our expectations, we did not forecast the degree of slowdown in ADRs in North America that we ultimately ended up seeing. And in the industry, you can see that industry analysts and hotel companies also are just kind of systematically reducing their expectations on room night economics as we move through this period. So that's the largest area.

In APAC, I think you're exactly right to point out the protest in Hong Kong. Some tensions between other countries is having some impact on travel and on ADRs, and we're certainly seeing that in our business as well.

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

And then, Mark, in terms of social media marketing channels, we have seen some interesting progress in some of the social media channels, Instagram, for example, to some extent, Facebook, largely around influencer-type campaigns. It's much harder to measure than traditional performance marketing channels. So it's tough to get a real read on the ROI. But in terms of just some of the softer metrics we're seeing around awareness and some of the other social metrics that you can take a look at, they are interesting, but still in the grand scheme of things relative to other performance channels are pretty small.

We continue to see good progress around digital video. We see good progress and we continue to like brand marketing, which has been something that's been part of our overall toolkit for a very long period of time. But again, on social, nothing that's significantly sort of needle-moving at this point.

Operator

Our next question comes from Justin Post with Bank of America Merrill Lynch.

Justin Post - *BofA Merrill Lynch, Research Division - MD*

Could you give us an update on the Vrbo rebranding? And do you think you can start seeing better results next year? Are we near a bottom? And then secondly, you mentioned the cloud expenses up $100 million next year. Anything else we should be thinking about when we do our 2020 models on a big-picture basis?

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

Justin, on Vrbo, listen, we continue to be happy with the trends we're seeing at Vrbo. They continue to see growth rates in the double digits, continues to be healthy. Unfortunately, even that is swamped by some of the SEO impacts and some of the replatforming work and sort of pulling spend away from some of the regional brands.

The plan is to roll out the Vrbo brand in more markets over the course of the next couple of quarters, and Vrbo does plan to put some marketing spend against those rollouts and then there'll be further rollouts across 2020.

In terms of better results, I think we're going to see the next several quarters, we expect there to be continued muted growth rates. And then we're optimistic that once we get past the lapping over some of these changes that became more acute in the first half of this year, that we should be in a spot where we're able to return to growth rates that we're more satisfied with.

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

Yes. And then, Justin, on your question about things to think about as we head into 2020. I would just say to be clear and as is usual for us at this time, we are right in the middle of our planning for 2020. So nothing specific to share.

You mentioned the cloud impact. That is one factor. These factors that we laid out in our prepared remarks on SEO headwinds, mix into higher-cost channels and the lower ADRs are things that we think will continue to impact us for the next few quarters.

The -- as Mark mentioned, it will take a little while, we think, for Vrbo to get back going the way we want it to be going and certainly contributing from a profit perspective. And so those are some of the things that would be, I guess, in the category of headwinds.

On the other hand, we are pushing forward on international expansion efforts. We're seeing good results from our supply acquisition efforts. As you can see from our sustained room night growth, we continue to focus on driving direct business and seeing good results there. And as we've mentioned, the Expedia Partner Solutions is doing well.

We also will obviously work to manage our overhead costs very tightly as we have this year, and we'll continue to do that as we move through 2020. So I think those are some of the factors that I would consider.

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

Yes. I would just add too that was in the long-term opportunity here. The playbook we're executing still very much does remain intact. I mean the focus areas we have around customer centricity, for example, are really focused on helping us deliver much better loyal customer relationships, squarely aimed at actually decreasing our reliance on a lot of these performance marketing channels that are causing us some angst. I think our locally relevant, globally effort, I think, is -- again, as Alan mentioned, we're going to continue to move out into international markets, and we continue to be happy with the progress we're making on the supply efforts.

And listen, the recent organizational changes that we -- that I spoke about in my prepared remarks are going to set us up well to much more effectively leverage a lot of the technical assets we've got across the organization, the data assets we've got and, at the same time, align our customer-facing and partner-facing teams just to better execute on the full strategy we've got in place.

So long-term opportunity remains very much intact and we've got some near-term headwinds that we're certainly navigating right now, but we're confident we'll be able to get through this.

Operator

Our next question comes from Eric Sheridan with UBS.

Eric James Sheridan - *UBS Investment Bank, Research Division - MD and Equity Research Internet Analyst*

Maybe 2, if I can. One, just following up on Vrbo. I guess just trying to discern out how much of this really is about the rebranding versus is there a changed competitive landscape in shared accommodations? Obviously, some of your competitors are trying to go after growth, some trying to highlight that growth in some of their own comments. Just trying to understand how much of this is within your control on the inventory level, on the execution-level branding versus what you might be seeing from the broader competitive landscape for those that are likely to book shared accommodations. That's number one.

And then number two, I'd love to get a little bit color on the Marriott agreement. I thought that was sort of an interesting nuance and highlighted by the company inter-quarter. Maybe give us a little bit of color on the underlying premise behind the agreement and how you think it plays out in what you're able to bring to market via your partnership with Marriott.

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

Sure. So listen, with respect to Vrbo, we can certainly point to things that we have done in terms of platform consolidation, reducing spend on certain flanker brands and point to direct impact on our top line trends.

That said, I think it's hard to ignore the fact that the overall competitive environment continues to be, well, competitive. But that said, Vrbo has got a -- it's got an excellent brand. Particularly here in the U.S., we're pleased with the growth rates we're seeing against that brand. They have got a great value proposition in terms of a lot of these large whole homes that exist that are great for groups and family. And certainly, they're working on continued customer-facing and partner-facing innovation to really press on that advantage.

So again, I think to the core question, is it competitive or is it internal? I think it's a combination of both. But we remain optimistic that through great execution on product development, continued international rollout of the Vrbo brand, getting the inventory from Vrbo onto the core OTA business to help bolster that international expansion with ultimately more demand, all of these things are things that point to a brighter future in Vrbo than certainly we've seen over the course of the last couple of quarters.

With respect to Marriott, listen, we're very pleased with that relationship and that deal. I think it's a unique, first-of-its-kind-type arrangement. And I think it's just an example of how we can bring the power of our platform to bear for our partners. We've really established an incredible network of connectivity and distribution reach across Expedia Group. And what we're able to do is help Marriott basically make sure that they are having their rates and inventory displayed in a way that they intend them to be displayed for their customers. And we think it's a great leverage of what we've got, and I think it helps them achieve what they want to. And we're optimistic that, ultimately, this will be the first of many because we think it's a great relationship.

Operator

Our next question comes from Kevin Kopelman, Cowen and Company.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Just had a couple of follow-up questions on the change in the EBITDA trajectory. First, could you talk about the increased payment processing costs? And what were those? And are those ongoing or more onetime in nature?

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

Yes. Thanks. Yes. So Vrbo has been using a third-party for payment processing. And we made the decision to move the payments onto the Expedia Group stack, so that we'll become the merchant of record for those. In order to make sure that we had a seamless transition there and that it went well, we put in place some incentive payments, if you will, for the third-party processor. And that's what we're referring to. Those were accelerated based on the pace at which we were moving the volumes over.

So not only were there expenses, but we pulled some of them forward from what maybe would have been in 2020. So that's the nature of what we're seeing there. There will be an impact of those in Q4 as well.

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

And again, I think that the rationale for getting on to the Expedia payment stack, we've got an excellent payments platform that has a broad array of payments methods, international exposure, world-class fraud detection, very good merchant arrangements with all of our providers. So we're confident this will unlock more growth for Vrbo going forward and we just need to get through this transition period.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Great. And then just a follow-up on Lloyd's question earlier about SEO. Can you give us just more details on kind of the specific changes that you saw in the search channel that led to some of that SEO traffic ending up more on paid traffic?

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

Sure. Again, a lot of it was around either different modules that they were introducing into search results that we're putting traditional SEO links down the page and then, in some cases, just steering more queries over to the hotel ads module or to the Google flights module than they had been doing historically, which ultimately just resulted in a traffic shift. And as we were prominently featured in the Google hotel ads product, of course, we were the recipient of that traffic. Again, pretty pleased with the returns that we see in that channel, but not as good as they were in the place the traffic was coming from.

Operator

Our next question comes from Deepak Mathivanan with Barclays.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Great. Mark, sorry to beat the dead horse on the SEO issue. This has been obviously a recurring and kind of highly volatile theme for several years now. Can you help quantify the exposure right now? I mean do you have more SEO traffic at this time? And then you noted that you expect the issue to sustain for a few quarters, but what is the broader, long-term strategy to steadily mitigate the exposure from a traffic standpoint? Do you think is it more branding? Or is there any other kind of marketing programs that you can scale to offset some of the impacts from this?

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

Yes. Thanks, Deepak. Well, I'll tell you, the SEO exposure is shrinking all the time. It is one of many sources for us, and we haven't gotten into the specifics of how big it is, but it is becoming less important to us over time for better or for worse.

Listen, the strategy to mitigate is really what we've been talking about, is being much more customer-centric. And for us, that means ultimately developing better loyal customer relationships so that we have customers come back to us directly. We've been very focused on, for example, building out great feature functionality in our apps and then across many of our brands, working to ultimately provide differentiated features in the apps that -- or differentiated offers in the apps that lead customers to come back to us directly. Obviously, just having great product and -- across the board, whether it's in the app or elsewhere is part of the strategy as well. We've got great rewards programs both at Hotels.com, stay 10 nights get 1 free; and then the Expedia rewards program, again, another reason for people to come back to us ultimately directly.

And then in terms of channels, again, we have been ultimately optimizing our marketing spend in some of these performance channels over the course of the last 1.5 years or so and ultimately putting more money into more of the branded channels. We mentioned some of the things we've been doing around influencers, which is not huge yet, but that's part of it. But also just television and digital advertising where we can really feature more prominently the brand and build the brand and really scream what's different about the brand has been part of the formula as well.

Operator

Our next question comes from Jed Kelly with Oppenheimer.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director and Senior Analyst*

Great. Just with the success you're having rolling out core OTA outside the U.S., do you ever think about unifying your vacation rentals more through the Expedia brand or the Hotels.com brand? And then on your comments on ADR, do you think that's more macro-driven? Or are we finally seeing some of the alternative accommodation providers have more of an impact?

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

Thanks, Jed. Listen, in terms of unifying the VR through BEX or HCOM, we're taking a bit of a hybrid strategy. So one of the things that we have done as part of our recent organizational realignment is brought the partner-facing or host-facing teams closer together between the main OTA team and the Vrbo team with a view, at a minimum, of having a more consistent go-to-market strategy and more alignment. So that as it relates to our partners, they really don't have multiple places to go to. They've got one. I think that's part of the equation.

The other side of it is as we get more of the inventory from Vrbo onto Brand Expedia and Hotels.com over time, it will provide us with the opportunity to drive more incremental volume to new properties internationally as we sign them up. Our plan is to still roll out the Vrbo brand, and we'll be thoughtful about how we do that, how quickly we do it, how much money we put against it. But really, the end state here is that we do end up having, at least in a number of markets, a pretty broad portfolio of brands where we've got the multiproduct brand and Brand Expedia that has alternative accommodations. You've got some of our single-lodging providers like Hotels.com also providing them. Of course, you've got Vrbo, which is dedicated to it as well. But again, part of the goal is to harmonize on the partner side and then distribute where we can through as many brands as we can.

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

And then, Jed, this is Alan. On your ADR question, I would say that the big factor there is going to be the macro trends, and you can kind of see that throughout the industry.

I would say our exact ADR trends do not match exactly with the industry, and I do think that's because of mix. You referenced if there's an impact from vacation rental. I think to the extent that we're integrating Vrbo's vacation rentals and our core lodging team is adding alternative accommodations as well, around the edges, that could have a little bit of an impact. But I don't think it would be meaningful at this point.

The other factor is there some geo mix in there. So certain countries where we're strong versus other countries where we're weaker do have different ADR -- just different overall ADRs. And so that plays into it as well. But really, the big story here is the macro slowing.

Operator

Our next question comes from Naved Kahn with SunTrust.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

It's Naved Khan from SunTrust. Maybe a clarification on the ADR. How much of the decline -- I mean I guess it's macro related, but how much of that is really travelers sort of trading down, meaning booking lower price point hotels versus a lowering in price point by the hotels across the board? And then you talked about sort of the SEO changes impacting maybe more of the nonlodging kind of products versus lodging? Is that a fair characterization? And how should we think about that impact across different geos?

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

So Naved, on the first one, it's really hard to say how much is travelers booking lower price point hotels versus the broader slowing that we're seeing. I would say that the slowing that we saw is not dramatically different from what we're seeing across the overall industry. So even though Alan called out rightly that there may be some mix impact in our channel, it's hard to call it specifically that it's consumer behavior or a trade-down at this point.

In terms of the SEO impact, I think the impact is pretty broad. It's just that when you have a lodging-only provider, they only see it in one channel versus if you've got multi-lines of business like air, activities, car, et cetera, you can feel it in other lines of business. And in some cases, those other lines of business can drive lodging business as well in terms of attach, so it can have a bit of a larger impact on the overall business, even though between lodging and the other products in total, it's not that big of a difference.

Operator

Our next question comes from Justin Patterson with Raymond James.

Justin Tyler Patterson - *Raymond James & Associates, Inc., Research Division - Internet Analyst*

Great. Can you talk about how OTA sensitivity differs today versus the last lodging cycle? It does seem like there's some more incremental headwinds this time through, and it doesn't seem like some of the counter-cyclical elements of OTAs are kicking in.

And then secondly, on the organizational realignments. Could you highlight how this realignment is different from some of the past ones? And how we should think about the time line towards seeing operational efficiencies?

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

Thanks, Justin. Listen, I think OTAs in this cycle in terms of what we saw during the last slowdown, I think we continue to be in a good spot. I think we are much larger than we have been historically, and therefore, our importance as a channel is more significant. What we've seen in past cycles is that corporate and meetings business starts to essentially get shrunk essentially as corporates start to tighten the belt. And that ends up creating more of a spot market in our channel where our partners are able to discount and, in many cases, discount in more opaque ways either through our Hotwire product or through our packages product, so that ultimately, they can offer incredible deals to our customers in a way that doesn't undermine their overall pricing structure.

I think that continues to be a big opportunity for us. I don't think that we're necessarily at that point in the cycle yet. You continue to see occupancy rates continue to be pretty healthy for us and healthy for the overall industry. So I think if we were going to see it, it's a bit earlier.

I would also say that in terms of our position in a downturn, we have introduced a bunch of new products that help our -- particularly our lodging partners target customers more effectively in a way that goes beyond just traditional discounting. Our Travelads product, for example, is a product that is more of a sponsored listings product, which allows our lodging partners to get demand in a really targeted way when they need it. And that's just significantly more sophisticated today than it was in the prior year, so I think represents an opportunity.

In terms of the organizational alignment, listen, we have not done a ton of organizational realignment over the years. But this one is significant in that it does bring a number of teams together in a way that does really align well with our overall strategy, bringing the partner-facing teams together. For example, I talked about the way that we'll have a much more unified go-to-market approach between Vrbo and our lodging team that -- and our traditional lodging team, and I think that's going to bear benefits over time and really allows us to unleash a lot of the benefits that we can deliver across the whole platform to our partners like we have with Marriott, like we have with United Airlines, for example. Bringing together more of our tech and data teams or aligning them more closely really allows them to be more effective in collaborating with one another and finding opportunities where they can leverage each other's technology, leverage each other's code.and redeploy resources against things that are more differentiated in terms of what our customers and partners might see.

And then we brought across some of the functions in our customer-facing team to be more effective in terms of international expansion, to find more opportunities to collaborate with one another in ways like we have done between Vrbo and Brand Expedia, for example, where in Vrbo, you're able to book hotels and cars; on Brand Expedia, you're able to log in with your Brand Expedia log-in credentials. So these are all changes that are aimed at unlocking new opportunities that are aligned squarely with our strategy in terms of how long it's going to take to scale these things. Listen, it is going to take some time to realize the full benefit of what we're able to do here, but we're confident that it's going to make us much more effective and efficient as we realize those benefits over time.

Operator

Our next question comes from Heath Terry with Goldman Sachs.

Daniel B. Powell - *Goldman Sachs Group Inc., Research Division - Associate*

This is Daniel Powell on for Heath. Just a couple of quick ones from us. First, we'd love to get sort of an update about where you feel you are on your international supply expansion. Should we continue to expect to see pretty elevated growth in those supply adds? Or do you feel like you're getting to a point where you have pretty competitive coverage across major markets? And then, secondly, just curious if you could give us an update on what you're seeing on the reward side, both from your perspective and what you run through Hotels.com, but also on the hotel side of things or the branded side of things and injecting rewards rates onto your platform.

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

Sure. So in terms of international supply expansion, we're pleased with what we see. We continue to add properties at a healthy rate onto the core platform. These include traditional conventional lodging and also include alternative accommodations.

I think we're again pleased with the progress we're making in the priority markets on that front and pleased with a lot of the work we're doing to actually enhance our product to make it more locally relevant.

As you've seen with our international room night growth, adjusting for Easter, it's broadly consistent with what we saw the last quarter. And I think it's a testament to some of the benefits that we're seeing.

That said, we have seen mixed results in some of these markets, depending on what's happening in various marketing channels. And as we add new properties, we have to be mindful of making sure that we balance both supply and demand. So I think the good news is we've got the capability to add more properties. We continue to add to our assortment, which is fantastic. And I think as we continue to expand international, we're going to blend those efforts with putting resources against other efforts that ultimately might move the needle more effectively to help us be more locally relevant.

In terms of the rewards programs, again, we remain very happy with the Hotels.com rewards program, results in higher customer loyalty, nice repeat rates that we see in that business. We do think that it is overall accretive to the P&L, and we're happy to have that program. It is a very strong program.

In terms of putting loyalty rates -- other partners' loyalty rates on our platform, we've had good success with a lot of the partners that we have rolled out with. And again, we're eager to continue to work in that way and other ways with our hotel partners as we move forward.

Operator

And our next question comes from Brian Nowak with Morgan Stanley.

Brian Thomas Nowak - *Morgan Stanley, Research Division - Research Analyst*

I have 2. Just to go back to the SEO issues. I guess I think you guys last updated guidance on July 25. Can you just sort of let us know around what period you saw the SEO issues start, just so we can sort of think about the sizing of a partial quarter impact on your ad spend for bookings, the way to think about full quarter impact in Q4 and to 2020?

And then on the comment about higher-cost marketing channels. Can you just help us understand what are the largest 1 or 2 marketing channels you're moving dollars toward? And then sort of bigger picture, what marketing channel are you sort of most optimistic about longer term that can maybe help you diversify your overall paid bookings mix away from Google?

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

Yes. Brian, this is Alan. Just in terms of kind of how the factors that we talked about on the call developed, we were -- you referenced our last earnings call, we were just finishing up the first half of the year that was a pretty terrific start to the year. We were ahead of our expectations at that moment and felt like the things that we saw in the business in the first half would carry out into the second half. As we moved through third quarter, we could start to see the impact from these SEO challenges and we also started to see the trends in ADRs working against us and with particular strength as we got to the very tail end of the quarter. So that's how I would think about it in terms of the challenges and the timing. As I said, we do expect them to continue to be a headwind for us in Q4 and into 2020.

On the -- just the last part of that SEO question in terms of where is the traffic going, I mean I don't have a specific answer for you other than to say if you're just thinking about the Google platform, to the extent that SEO is pushed lower on the page and people who normally maybe would have transacted through those links are moving to paid links, you're looking at SEM and Google Hotel ads. And as Mark said, it's -- we see good returns on those volumes except for the fact that volumes through SEO are essentially free to us. And so going from free to anything, especially the other Google paid placements, can create a sizable headwind for us.

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

And then, Brian, in terms of other channels, I mean we're actively spending more in digital video. We're spending more in traditional television. I mentioned experimenting with some of the influencer-type things on Instagram and other social channels. As I think you know, we've got a sponsorship for Champions League in Europe, which we've been pretty happy with so far.

So the goal here is to help start basically accelerating our direct business, and we were happy with the growth in our direct channels in the quarter. And overall, our strategy is to continue to actually differentiate the product and build more direct business over time. So I think you'll see us continue to find new channels that are more branded in nature to help build our direct business.

Operator

Our next question comes from Brian Fitzgerald with Wells Fargo.

Brian Nicholas Fitzgerald - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

A couple of quick ones. You mentioned that lodging stack fully cut over by the end of the year. How does that match up with your original plans? Do you see accelerating trends as you apply best practices or get scale or optimized tools? And then related, does the air stack switch make for a lighter shift? So that's the first question.

Second one was just simply around, Mark, you mentioned removing friction with a unified sign-on at point of sales across Expedia and Vrbo. Is that predicated on -- did you have to do the move off of the Vrbo third payment provider? And then we'd imagine you get incremental or better or fresher data as you unify those 2? And do you see that levered into better first-party data, means better targeting amongst the whole platform, so tailwinds in targeting?

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

Thanks, Brian. I'd say broadly, the cloud migration is moving along nicely. It's always impossible to estimate exactly when you're going to get it done. So we're pleased with the progress. And I think where we thought we'd be at the end of the year versus where we are, I think we're broadly in line with where we want it to be.

In terms of the air stack, I think the team has done a lot of great work to actually get ourselves cloud-ready there. Obviously, the lodging business for us is one of the biggest lifts. And so the air business, again, the team has done a great job, and I think that's something that we'll be moving in towards the end of this year and into the following year as well.

In terms of removing friction, really, what we're talking about is enabling Vrbo users to log in using their Expedia credentials. From that point on, yes, we're able to collect more information on them and tag more of their intent towards their particular user profile. And we are interested in making sure that we can deliver the most tailored and relevant experiences to our customers. So I think that type of thing represents an opportunity for us to do that better. It is not related to the payment side of things. So it's completely different.

Operator

And our question comes from Stephen Ju with Crédit Suisse.

Stephen D. Ju - *Crédit Suisse AG, Research Division - Director*

So Mark, anything you can share about the consumer awareness as well as the willingness to transact in the 650,000 Vrbo properties you've now integrated? And is that improving quarter-on-quarter, year-over-year? Are you seeing any sort of conversion rate headwinds? Because it seems like, conceptually, if you present people with more choice, they should respond positively.

And also trying to think about when some of the SEO headwinds for Vrbo should and could end? Because our recollection for when it was a publicly traded company was that Google will derate one property versus another if they see the same inventory on both. So where are you in terms of integrating what properties that can't be integrated from Vrbo to Brand Expedia?

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

Yes. Stephen, so on the, basically, the performance of the Vrbo properties on the core OTA side of things, it's still relatively small. It's growing very quickly. And the teams have continued to test on when the right thing -- the right time to present the properties. I think as a reminder, each of these properties essentially represents one unit as opposed to a traditional hotel that may be, call it, 50 different units. So the total volume potential of these is just smaller than a traditional property. But certainly, when you present these to the right customer at the right time, they definitely improve conversion. You just got to be smart about when you present them and do it in a very targeted way because customers also definitely want to have some curated results that are relevant just to them.

In terms of SEO headwinds for Vrbo, listen, I think the key here is that we are really putting our weight behind the Vrbo brand and as a result of that have done a bunch of platform consolidation work. Really, we saw the step-up in the headwinds from SEO really start at the beginning of this year, and I think we're into the end of 2020 before we see those types of things lapping.

But I think, listen, SEO is a headwind for everyone in the Internet. I think you saw us call it out, and that's why Vrbo has been pretty focused on defining the real differentiated value proposition, being smart about their brand spend and exploring more digital video-type advertising. And again, against the Vrbo brand itself, which is growing double digits, we like the progress we're seeing there.

Operator

Our next question comes from Ron Josey with JMP Securities.

Andrew M. Boone - *JMP Securities LLC - VP*

This is Andrew Boone on for Ron. I'd like to go first to your supply strategy. Just with 1.4 million properties that are now on the platform, can you talk about your strategy with priority markets? Are there more priority markets today versus, say, 1 year or 1.5 years ago? Are you going deeper? Or are you guys adding more priority markets?

And then secondly, Google rolled out BERT a few weeks ago. Just with all the talk on SEO, have you guys seen any impacts there?

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

Sure. So in terms of priority markets, we did expand the number of priority markets from the first wave that we did. And we are essentially going not completely broad. We have expanded the numbers, but we are trying to go deep and make sure that, ultimately, we have a broad selection not only in the primary markets, but the secondary and tertiary markets, which is important to make sure that you can develop a locally relevant product that ultimately customers will go back to again and again and again.

So with respect to BERT, listen, I think Google continues to experiment with new products. I think where we see the biggest impact is when those products ultimately take away real estate from what was traditionally free channel. So I think it's too early to call an impact on that particular product. But generally, the trend is that Google does continue to push for more revenue per visitor. And I think it's just the reality of where the world is in the Internet and the importance of Google at the top of the funnel.

Operator

Our next question comes from Brent Thill with Jefferies.

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Mark, in Europe, I'm just curious how that's fared relative to your plan and your outlook, Alan, for Q4, directionally, how you're thinking about the region.

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

Yes. I think Europe saw a similar type of ADR softening that we saw across the U.S. and some of the regions. I think -- so that was a factor for us. We were broadly happy with our volumes in Europe. Again, we've been in a number of those markets with our Champions League sponsorship and some of the supply acquisition efforts that we've been pushing, I think, maybe a little bit isolated from some of the things that may have been happening there, but it was mixed. I mean we saw weaker in the U.K., again, I think on Brexit concerns. And country by country, there were mixed results. Either because of things that we were doing in performance marketing channels or whether it was because of macro environment, it was hard for us to tell. But broadly speaking, we were comfortable with the way that Europe played out.

Operator

Our next question comes from Doug Anmuth with JPMorgan.

Douglas Till Anmuth - *JP Morgan Chase & Co, Research Division - MD*

I have 2. First, just if you could talk about competition and the dynamics there in APAC in particular, just with some of the local players that are really getting more aggressive from a global perspective. And then second, on holistic travel, it feels like the market and other players are kind of just shifting more in your direction. Can you just talk about what you're able to do there just to continue to differentiate the products and platforms?

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

Yes. Listen, the competition in Asia continues to be fierce. You've got a number of regional players that continue to do really significant discounting. And a couple of pan-regional and global players that are doing the same, in many cases, leveraging rates that maybe shouldn't be online and actually putting them online. So it does continue to be a pretty fierce environment for us and for, I think, everyone in the region. We are having success in a number of markets in Asia. But in other markets, it does end up being a little bit more challenging.

We do have, however, with our Expedia Partner Solutions business, the ability to tap into that market. And we are powering a number of players in the Asia Pacific region with our inventory, both in APAC and then around the world as well. So we are able to benefit from what's happening there. But for our consumer brands, it does continue to be a pretty competitive environment for us.

And sorry, on holistic travel. So we continue to innovate on finding ways where we can leverage our flights and car rental and hotel advantage not only in terms of just actually being able to offer discounts, but also ultimately being able to, in the future, provide just more information on flight -- flight delays, et cetera, even for hotel bookers.

So the team's got a bunch of plans to actually build more in the way of the connected trip's experience beyond what is our traditional core competitive advantage, which is being able to bundle things together, have your itinerary all in one place and do so in a way that ultimately can deliver great savings for our customers.

Operator

Our next question comes from Tom White with D.A. Davidson.

Thomas Cauthorn White - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Great. Just a clarifying question on the mix shift to higher-cost marketing channels. Was that more just sort of a passive event, Alan, you mentioned resulting from the search platforms kind of prioritizing their own vertical search experiences and that impacting your mix? Or was it also -- was there any sort of proactive steps that you guys were taking to maybe lean into CPC bids or specific higher-priced channels to kind of try and preserve unit growth in the face of some of the pressures you talked about?

And then just secondly, on the free cash flow conversion comment. Alan, I'm just hoping you maybe you could provide a little bit more color there. Any thoughts on magnitude or potential timetable that you can share?

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

Yes. Tom, so on the first question, I would say more of the former than the latter. I mean it's -- if you think about what we described here, it's principally Google pushing SEO down the page, and there's just a natural outcome of that. Obviously, the team is very dynamic and is constantly looking at opportunities and trying to do a good job of balancing room night growth with our overall profitability. So there are elements of that. But for the most part, I think it's more just the natural shift as SEO gets tougher to come by.

On the free cash flow bit, I mean, I think we've been clear that we do expect over the long term to continue to deliver healthy and solid adjusted EBITDA, which is where it all starts. The next main factor here is that we will be moving through and completing our Seattle facility. And so that will provide a tailwind on our free cash flow. We expect to continue to see a good tailwind on our working capital flows as our merchant business continues to grow. So all of that together, we think, adds up to a situation where we can drive healthy free cash flow and good cash flow conversion going forward.

Operator

This will conclude our Q&A session for today's call. I will now turn it over to Mark Okerstrom for closing remarks.

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

Well, thank you all for listening today and a huge thanks to Expedia employees around the world. While core did not play out as we had planned and we've got lots of work ahead, we're seeing great progress across many areas and remain well positioned to capitalize on the significant long-term opportunity in the travel market ahead. We look forward to talking to you next quarter. Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's presentation. You may now disconnect.
