PRICELINE GROUP INC (PCLN) Earnings Report: Q4 2015 Conference Call Transcript

The following PRICELINE GROUP INC conference call took place on February 17, 2016, 07:30 AM ET. This is a transcript of that earnings call:

Company Participants

- Darren Huston; Priceline Group; CEO
- Dan Finnegan; Priceline Group; CFO

Other Participants

- Tom White; Macquarie Research Equities; Analyst
- Brian Fitzgerald; Jefferies; Analyst
- Naved Khan; Cantor Fitzgerald; Analyst
- Mike Olson; Piper Jaffray; Analyst
- Mark Mahaney; RBC; Analyst
- Heath Terry; Goldman Sachs; Analyst
- Justin Post; BoA Merrill Lynch; Analyst
- Douglas Anmuth; JPMorgan; Analyst
- Ken Sena; Evercore Partners; Analyst
- Lloyd Walmsley; Deutsche Bank; Analyst
- Peter Stabler; Wells Fargo; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to The Priceline Group's fourth-quarter 2015 conference call.

The Priceline Group would like to remind everyone that this call may contain forward-looking statements which are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially from those expressed, implied or forecasted in any such forward-looking statements.

Expressions of future goals or expectations or similar expressions reflecting something other than historical facts are intended to identify forward-looking statements. For a list of factors that could cause the Group's actual results to differ materially from those described in the forward-looking statements, please refer to the Safe Harbor statements at the end of the Group's earnings press release, as well as the Group's most recent filings with the Securities and Exchange Commission.

Unless required by law, The Priceline Group undertakes no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise. A copy of the Group's earnings press release together with an accompanying financial and statistical supplement is available in the For Investors section of The Priceline Group's website, www.pricelinegroup.com.

And now, I'd like to introduce The Priceline Group's speakers for this afternoon, Darren Huston and Daniel Finnegan. Go ahead, gentlemen.

Darren Huston (CEO):

Thank you. Welcome to Priceline Group's fourth-quarter conference call. Thank you for joining us before the market opens this morning in New York. I'm here in Amsterdam with Priceline Group's CFO, Dan Finnegan.

The Group reported another solid quarter with consolidated gross bookings of approximately $12 billion, up about 24% on a constant currency basis, or 13% year-over-year in US dollars. Our customers booked accommodation reservations for over 99 million room nights in the quarter, up 27% year-over-year.

Gross profit was up 12% or about 23% on a constant currency basis. Adjusted EBITDA was also up 11% to $790 million. And finally, our non-GAAP earnings per share was $12.63, surpassing FactSet consensus estimates of $11.81 per share and our guidance for the quarter.

Now I'd like to take a moment and reflect back on our full-year results. Our customers made reservations for over 432 million room nights on Priceline Group platforms in 2015, over twice as many as our next biggest competitor. Despite the law of large numbers, we organically grew this business at 25%, down only 3 percentage points from 2014's growth rate and exited the year growing more quickly than we were growing when we entered it.

The business is very profitable, generating $3.7 billion of adjusted EBITDA and a 42.6% non-GAAP operating profit margin. I believe that the solid performance in 2015, and many consecutive years of strong growth and profitability, have been made possible by competitive advantages we have developed through the skill and hard work of our people around the world.

Our capabilities in scale and partner acquisition, customer experience, and efficient demand generation, plus our large installed base of accommodations and loyal travelers give The Priceline Group a competitive moat that is deep and wide. Let me expand on this point a bit. Being a leader in online travel and building an experienced marketplace isn't achieved by simply electronically connecting demand with supply. It may be a surprise to some, but about two-thirds of our employees are working in either the supply or customer service organizations.

Only KAYAK, our one media asset, does not have a similar model. Our employees work out of 239 support offices in 173 cities around the world, working daily with partners and customers to deliver the absolute best booking experience wherever our customer comes from and wherever they're going.

On the supply side, we added over 200,000 properties during the year on Booking.com, covering everything from igloos to shared stays, while maintaining stable take rates and a fee-free model to the customer. Booking.com now has over 850,000 hotels, homes, and other places to stay in over 220 countries and territories across the globe, up 34% from last year.

The hard work of making this a daily reality is achieved by thousands of dedicated and energetic people around the world, adding these properties and then working with our properties on an ongoing basis to ensure that our customers have the most choices of places to stay at the best prices available. We offer, by far, the most directly bookable lodging choices to our customers, with over 22.6 million rooms potentially available on our websites, including 6.9 million rooms in vacation rentals and other non-hotel properties.

With our worldwide team and market-leading profitability, we are expanding this low friction model more aggressively into the single owner, single room market as it continues to mature. We strongly believe that this fee-free, experience-centric model which makes booking homes and apartments as easy and trustworthy as booking a hotel will be the winning model long-term.

On the customer experience side, the complexity of providing a world class digital experience for customers becomes more daunting each year with various browsers and operating systems offered on desktop and mobile devices. On top of that, you have new platforms and capabilities being built every day, and for each of these, we need to make an intelligent decision about where and how to participate. The good news is the tools are becoming better, and customers continue to want to live more of their lives digitally.

We have over 2,500 talented developers and other technology professionals working across our brands to offer our customers the best online booking experience on our desktop and mobile websites and apps, optimized through hundreds of thousands of experiments.

We believe Booking.com has the highest converting online accommodation reservation path in the world, achieved through a deeply engrained culture of innovation that results in experimentation at a transactional data scale and velocities that few companies can match.

Our content is best-in-class with high resolution photos, detailed property descriptions, and 77 million-plus verified and fresh reviews for properties in even the most far-flung destinations. We have thousands of customer service professionals stationed all over the world helping our customers in 42 languages, 24 hours a day, seven days a week.

We think our approach adds up to a great experience for our customers, which helps us continue to grow the direct share of our business with outstanding everyday pricing and repeat traffic, versus the alternative, which is to buy the business with coupons or discounting, transaction by transaction.

Booking.com surpassed 100 million customer accounts during 2015, and had our 1 billionth guest stay at one of our partners, approximately 300 million of those in 2015 alone. Another testament to our success at earning long-term loyalty.

We invested $3 billion in marketing during 2015 to build our brands around the world and bring new customers to our websites at profitable ROIs. Our historical competitive strengths on the desktop have translated very well to mobile.

Our talented teams use proprietary quantitative tools to manage bidding on hundreds of millions of multilingual key words across desktop and mobile platforms, successfully balancing ROI discipline with strong growth. We continue to command a leading share of the demand channels we participate in, profitably converting shoppers into buyers and buyers into loyal, long-term customers.

Every year is an investment year as The Priceline Group, while every year is also an opportunity to deliver outstanding bottom line results. We evaluate every opportunity with a long-term lens, requiring that it deliver value for our brand franchises tomorrow beyond just delivering transactions today. 2016 will be no different as we invest in exciting new opportunities like OpenTable's international expansion or BookingSuite cloud software offers or Booking.com for business, while maintaining superior operating margins that will allow us to win in the face of heated competition.

And you can be confident that we're not standing still. The Priceline Group will continue to work hard to stay a step ahead of the competition with our unique combination of institutional know-how, culture, systems and focused passion. We don't take any competitor lightly, and we compete ferociously everyday, continuously seeking a higher executional gear in every facet of our business.

Booking.com, of course, makes up the majority of our business. However, the Group also has a portfolio of valuable and complementary brands, each of which makes money and has the aspiration to grow and build vertical mastery in their respective area of focus.

We have new leadership at Priceline.com and OpenTable , and both businesses are responding with a renewed energy and a strong commitment to profitable growth.

Agoda and RentalCars.com both continue to improve and differentiate their respective products, and both look to drive more business direct and through improved mobile experiences. And finally, KAYAK is an outstanding business that is being smartly run and continues to contribute to the Group beyond our initial expectations.

I give these other brand teams a lot of independence, and this has engendered a real performance-driven culture. Through our portfolio of brands, we aspire to achieve the Group's mission to help people experience the world and become a global marketplace for experiences.

I thank my colleagues around the world for delivering another great year. Their skill and dedication has helped build a great business with strong competitive advantages that have been responsible for our past success and will help us continue to succeed in the future.

I'll now turn the call over to Dan for the detailed financial review. Dan?

Dan Finnegan (CFO):

Thanks, Darren.

I'll discuss some of the highlights and operating results and cash flows for the quarter and then provide guidance for the first quarter of 2016. All growth rates referenced in my comments are compared to the prior year, comparable period, unless otherwise indicated.

Q4 was a strong quarter for The Priceline Group with accelerating room night growth and the second consecutive quarter of solid operating margin performance. Growth was strong across all channels and geographic regions, which we believe indicates a generally healthy macro travel environment.

Our global room night growth rate declined by more than 10 percentage points for a two to three week period after the terrorist attack in Paris compared to what it had been before the attack. Growth bounced back strongly in December, and this momentum has carried over in Q1, as I will discuss further when I get to guidance.

Room nights booked grew by 27% in the fourth quarter, accelerating compared to the 22% growth rate for Q3. Rental car days grew by 11% in Q4 compared to Q3 growth of 13%.

Average daily rates for accommodations, or ADRs, for Q4 2015, were up on a constant currency basis by 1% for the consolidated group. Foreign exchange rates, again, presented a significant headwind to our growth rates expressed in US dollars due to the strong dollar and our business mix, which skews heavily international.

Our Q4 gross bookings you grew by about 24% on a constant currency basis, but by only about 13% expressed in US dollars compared to prior-year. International gross bookings grew by about 29% on a constant currency basis and by 16% expressed in US dollars.

Gross bookings for our US business decreased by about 8%. We believe US performance was impacted by TV advertising decreases in the second half of 2015 as the Priceline.com team transitioned to their new brand campaign which recently launched in Q1.

In addition, global airfares were down by about 15% over the last several months according to KAYAK flight search data, which significantly impacts Priceline.com's gross bookings growth, but has no impact on gross profit growth.

Gross profit for the quarter for The Priceline Group was $1.9 billion, and grew by about 23% on a constant currency basis and by 12% in US dollars compared to prior-year. Our gross profit take rates remain stable, as they have been for quite some time now. We believe that our revenue margins have been, and should continue to be, sustainable due to our position as a relatively low cost distribution channel that drives significant demand to our partners.

Our international operations generated gross profit of $1.6 billion, which grew by about 25% on a constant currency basis and by 12% in US dollars compared to prior-year. Gross profit for our US operations amounted to $268 million, which represented 11% growth versus prior-year. Advertising and other revenue, which is mainly comprised of KAYAK and OpenTable revenues, grew by 17% in Q4 compared to the prior year.

Operating margins exceeded our guidance and were similar to Q4 last year. Non-GAAP operating income amounted to 41.3% of gross profit for Q4 compared to 41.4% in Q4 last year.

Online ad ROIs were better than our forecast, but online advertising delevered compared to the prior year due to the acceleration in gross bookings late in the quarter, which will benefit revenue in Q1 and beyond when checkouts occur, as well as the impact of terrorist attack on cancellations. Offline advertising came in slightly favorable to our forecast and is down year-over-year due to a shift in spend from offline to online advertising for KAYAK, reduced advertising at Priceline.com, as I mentioned a moment ago, and the impact of foreign exchange rates on Booking.com's offline advertising expense, which grew by 18% in euros.

Non-advertising operating expenses were also favorable to our forecast and only generated 11 bips of margin pressure compared to prior year. Adjusted EBITDA for Q4 amounted to $790 million, which exceeded the top end of our guidance range of $760 million and grew by 11% versus prior-year despite the significant negative foreign currency translation impact with the stronger US dollar.

Non-GAAP net income increased by 11%, and non-GAAP EPS grew by 16%, including increased interest expense from our recent bond offerings and the beneficial impact of lower share count from stock repurchases. In terms of cash flow, we generated $881 million of cash from operations during fourth-quarter 2015, which is about 17% above last year and is also impacted by unfavorable foreign exchange rate translation.

For the full year, we generated operating cash flow of $3.1 billion and spent $174 million on CapEx, which means about 34% of our gross profit converted into free cash flow.

We used our cash during the year to repurchase 2.5 million shares of our common stock for $3.1 billion. Darren just spoke about some of our operational competitive advantages. I believe that our market leading profit margins, free cash flow, impeccable balance sheet and solid investment grade credit rating collectively constitute a competitive advantage that gives us significant financial flexibility to invest in our business to drive growth and positions us favorably versus our competitors.

Our Board recently gave us a new authorization to repurchase up to $3 billion of our common stock. We expect to execute this program consistent with a pattern we have established over the last couple of years to return capital to shareholders at a pace that we think makes sense based on the price at which our stock is trading and potential other uses for such capital.

Our cash and investments amounted to $10.6 billion at December 31, 2015, with about $800 million of that balance in the US.

Now for Q1 guidance. Our quarter is off to a strong start, as I mentioned a moment ago. Some of the strength in December, and thus far in Q1, is likely attributable to Chinese New Year, Carnival and Easter happening earlier this year. Leap year also helps our forecast slightly relative to last year by adding an extra day to the quarter.

Although we worry about macro weakness evident in slowing economic growth, dropping oil prices, and stock market volatility, the macro travel environment appears healthy to us. Lower oil prices have contributed to significantly lower airline ticket prices and leave consumers with more discretionary funds that are available for travel.

Lastly and most importantly, a combination of strong core execution and the benefits of a number of growth investments we have been making are helping to drive the Group's success, and I sincerely thank my colleagues around the world for their efforts.

Our growth continues to be strong across all channels and regions. Our guidance assumes that our growth rates will decelerate as we progress through the quarter mainly due to the size of our business and consistent with long-term trends. We are pleased with the brand marketing we get through TripAdvisor's instant book ad placement, but given the relative size of our business and our experience so far, we don't expect that instant book will significantly impact our top line growth or add efficiency.

Our Q1 forecast assumes foreign exchange rates of $1.12 per euro and $1.44 per British pound for the remainder of the quarter, which result in average exchange rates that would be weaker by about 2% for the euro and about 5% for the British pound as compared to the prior year.

Many other currencies in which we transact are also significantly weaker versus the US dollar than they were in Q1 last year. As a result, our gross bookings, gross profit, operating expenses, adjusted EBITDA and non-GAAP net income will mathematically translate into fewer dollars than they would have at last year's exchange rates for Q1.

As you can see in our guidance, the Q1 impact of currency fluctuations on our dollar reported figures, while still meaningful, is less severe than what we experienced during 2015. Barring further deterioration in exchange rates, year-over-year currency comps will become even less challenging after Q1.

As I mentioned when we reported last quarter, we will no longer report US gross bookings as a separate statistical metric. We believe the usefulness of this metric has diminished due to the relative size of our Priceline.com business to our consolidated results, and because our other two US brands, KAYAK and OpenTable , do not have gross travel bookings. The metric also excludes US inbound, outbound and domestic business for Booking.com.

We will continue to report revenue and gross profit for our US business, as we have in the past to give insight into its performance. We are also adding guidance for consolidated room night growth to give visibility for this important metric.

For Q1 guidance, we are forecasting booked room nights to grow by 20% to 27% and total gross bookings to grow by 18% to 25% on a constant currency basis, and by 12% to 19% in US dollars.

Our Q1 forecast assumes that constant currency accommodation ADRs for the consolidated Group will be up by about 1% compared to the prior-year period. We expect Q1 revenue to grow year-over-year by approximately 9% to 16%. We expect gross profit to grow by 20% to 27% on a constant currency basis and by 14% to 21% in US dollars.

We expect about 140 bips of deleverage in non-GAAP operating margins compared to prior-year expressed as non-GAAP operating income as a percentage of gross profit. The deleverage is mainly attributable to our assumptions for online ad efficiency.

Our online advertising efficiency forecast, as usual, assumes deterioration from current levels and provides us with flexibility in a dynamic market to follow our consistent approach of advertising our brands at reasonable ROIs.

Our adjusted EBITDA is expected to range between $580 million and $620 million, which, at the midpoint, is an increase of 13% versus prior-year. We estimate that the currency impact on EBITDA growth is similar to the impact that we are forecasting for gross profit. Our non-GAAP EPS forecast includes an estimated cash income tax rate of approximately 16%, comprised of international income taxes and alternative minimum tax and state income taxes in the US.

We are targeting non-GAAP fully diluted EPS of approximately $9 to $9.60 per share, which, at the midpoint, is an increase of 15% versus prior-year. Our non-GAAP EPS guidance assumes a fully diluted share count of 50.5 million shares based upon yesterday's closing stock price and reflects the beneficial impact of the common stock repurchases we made in 2015.

We forecast GAAP EPS between $6.90 and $7.50 per share for Q1. The difference between our GAAP and non-GAAP results is driven by non-GAAP adjustments that are detailed in our earnings release.

Consistent with past practice, we have hedge contracts in place to substantially shield our first quarter EBITDA net earnings from any further fluctuation in the euro and British pound versus the dollar between now and the end of the quarter. The hedges do not offset the impact of translation on our gross bookings, revenue, gross profit or operating income. They also do not hedge us against fluctuations in other currencies and do not hedge our earnings beyond the first quarter.

Our forecast does not assume any significant change in macroeconomic conditions in general or in the travel market in particular.

We will now take your questions.

QUESTIONS & ANSWERS

Operator:

Thank you.(Operator Instructions)

Our first question is from Tom White with Macquarie.

Tom White (Analyst - Macquarie Research Equities):

Great. Thanks for taking my questions. Just one on the TripAdvisor instant booking, I think you said no kind of impact contemplated in 2016, but was there any discernable impact to the 4Q room night growth?

And then just on your comments on take rates, sounds like things are stable. I know this isn't a perfectly clean calc, but if I look at gross profit growth, kind of on an FX neutral basis, that lagged room night growth a bit in the fourth quarter, for the first time in several quarters. Can you maybe just comment a bit on the drivers of the delta there, if take rates are stable? Thanks.

Darren Huston (CEO):

Tom, I'll take the first one on Trip Assist. I'll let Dan take the second one.

I think one of the headlines of Trip Assist is it's still very early. As Steve would tell you, they're still rolling out the product. It's important to understand that TripAdvisor makes up a low single digit percentage of our business, and Trip Assist within our TripAdvisor business is a small percentage of our business.

We have found, at least, we're happy with the brand impact. That was one of the reasons we did that.

We're happy with the consumer behavior we see. But it's still small, and to be honest, if it becomes two or three times the size it is today, it's still quite small for us from a materiality perspective. Again, we're happy with the execution, the teams have been connecting really well and we're curious to see how big it can become.

Dan Finnegan (CFO):

On your second question, Tom, if you look at the gross bookings that we generated in Q4 and the take rate, the revenue that we'll ultimately generate from those, the rate is stable. It's really just a book versus stay difference.

We typically see this when we have a quarter where we accelerate to the extent that we did, that due to the lag between when the booking occurs and travel occurs, the growth in gross profit typically lags that growth in gross bookings. And in particular, the strength at the end of the quarter, last month, will benefit to a greater extent in Q1 and beyond than Q4.

Tom White (Analyst - Macquarie Research Equities):

Great. Thank you.

Darren Huston (CEO):

You're welcome.

Operator:

Brian Fitzgerald with Jefferies.

Brian Fitzgerald (Analyst - Jefferies):

Thanks, guys. Maybe on OpenTable first, congrats to Christa as she stepped into that OpenTable CEO role this quarter.

You mentioned OpenTable international expansion in 2016. Can you remind us how many countries they're in currently, and where do you see opportunities for expansion?

And then, along the same lines, there are many players that are attacking that local reservation market on a global basis. How important are the relationships there versus maybe having an all encompassing platform with reviews, with reservations and maybe even with delivery options, or does it come down to having the best tech and the best competitive rates? Thanks.

Darren Huston (CEO):

Okay, thanks, Brian. As mentioned in my prepared remarks, we feel really good about where Open Table is. We knew at the time we acquired it that we might have to make some changes in leadership. Christa's done an awesome job. The team hit all of its Q4 KPIs, and these are all about how do we get medium to long-term momentum.

We are currently primarily in the United States, but we also have operations in Japan, the UK, Germany. We made an acquisition with AS digital that put us into Australia. There are also, by the way, a number of restaurants that use OpenTable software all around the world, although we may not have a consumer facing site.

The whole process of globalizing OpenTable has been -- you'll see recently their latest app update allows Americans to book in London. You'd thing that was the simplest thing and that should have been done years ago, but there you go, it's done now. This allows the app to become global.

There's more things around languages as well. You go to book a restaurant in Germany and you're from the United States, you're able to see the menu and the product in English. That's the kind of work that's going on. As that re-platforming gets done, and we expect that work to be done in this year, then we have some amazing tools to be able to offer both the software proposition to restaurants, as well as the demand proposition.

You'll see on Booking.com for instance, if you search New York, we've got a beautiful little ad there that says hey, book a restaurant in New York through OpenTable . Those things we've found to be positive experiments. That's where we are. I'm optimistic.

I think ultimately there is a traveler network effect. Restaurants are a more local business than, say, hotel staying of course. But on the other hand, transient travelers are extremely valuable to restaurants.

Filling those last few tables can often be the difference between making money and not making money, and they realize that those of travelers have choice, and they're relatively not near as informed as maybe local people. We think that's a valuable business and we're seeing good results so far, but there's still a lot more work to do.

Brian Fitzgerald (Analyst - Jefferies):

Great. Thanks, Darren.

Operator:

Naved Khan with Cantor Fitzgerald.

Naved Khan (Analyst - Cantor Fitzgerald):

Thanks. The growth in properties continues to be pretty strong, and Darren, can you add some color as to where you're adding most properties, which region you're seeing most strength in?

Darren Huston (CEO):

Okay. Thanks, Naved. The really important math, here, is the difference between properties and rooms, and we talked about the 22.6 million rooms we have on our website.

In Europe, we're actually still adding a lot of properties, but because this is our most mature market, those properties are becoming smaller and smaller. By the way, they're still tremendously valuable, because all of these smaller properties add tremendous diversity to our accommodations base, therefore being able to fit very specific needs.

They also help us in low availability times, if there's a conference or something, these properties can help fill demand when you're in a supply constrained environment. So Europe has a lot of properties that are getting smaller and smaller.

That's the nature of the European business. For instance, in Italy, at a time, we're adding 100 properties a day, because these are very small properties in small places, kind of mom and pop operated type product. In other parts of the world, we're still adding many large multi-room. I think India, China in particular, China we've gone, entered the year with about 6,500 properties, exited the year with 35,000 properties. A lot of that was organically built.

In China, we have a lot more to do, just adding really large hotels and properties. The challenge in China is making sure you have enough domestic demand to fill those. Inbound China is not a huge market, but domestic China is a huge market, and we're filling those beds through partnerships within China including our relationship with Ctrip.

India is another one that has -- just seems to have unending potential for us, and we're busy there building out that market place. I'd say another part of the world is Africa, Central America, these are areas still where we're adding hotels. But at some point we will have most of the world's hotels, and then there's still a lot of extra property count in these single owner, single apartment type product, almost endless to some degree it seems. But we're having to add those, a room/property at a time, and that's obviously important and tough work.

Naved Khan (Analyst - Cantor Fitzgerald):

Okay. That's very helpful. And then one follow-up. Earlier in your previous calls, Darren, you've talked about how Europeans were sort of more inclined to stay within Europe, just because of maybe FX becoming more of a headwind to travel abroad. What kind of flows are you seeing in terms of tourism or people staying within boundaries or not?

Darren Huston (CEO):

Thanks for that. There's two effects we always see of currency. One is the absolute level of the currency, and the other issue is volatility. And a lower euro has a big impact, but it's also the movement in the euro, because people need to get used to the fact that the euro's now $1.11 and is no longer $1.35.

So we certainly see now that the euro has stabilized, that's had a positive impact on year-over-year base of Europeans starting to travel back to America, starting to travel to the UK, starting to travel to higher currency zones. I think the other point that Dan made, the KAYAK data that shows that flights are down 15% year-over-year, that actually plays into the travel budget as well.

So we're seeing more positive flows of Europeans into these higher currency markets. It certainly hasn't recovered to the time of the $1.35 euro, but it's more positive than it was a year ago. That said, intra-EU travel is still -- we're seeing very positive impacts there.

There's a number of crises in the world, Tunisia, Egypt, even Turkey. The positive there, for us, is that many of these markets are wholesale kind of package travel markets. We have properties there, but they're traditionally sort of the Thomas Cooks of the world. And a lot of that travel is now ending up in Italy and Spain and Southern France, and that's more of a retail market that plays also to our strength, and that's another trend we've been seeing recently.

Naved Khan (Analyst - Cantor Fitzgerald):

Thank you.

Operator:

Mike Olson with Piper Jaffray.

Mike Olson (Analyst - Piper Jaffray):

Good morning. Just one question. I know you aren't guiding beyond Q1, but, high level, how are you thinking about go-forward operating margin trends as we lap the acquisitions which could help non-advertising operating leverage balance with dynamics of advertising ROIs and the related impact on advertising expense leverage or deleverage in 2016?

Dan Finnegan (CFO):

Hi, Mike. We don't have guidance for you beyond Q1, but as we've said on previous calls, we expect that we can deliver operating leverage in the non-ad OpEx over time.

The business is growing fast. It's scalable. And so even with the investments that we're making to drive growth in the future, we think that we can deliver leverage there.

Offline advertising, we're going to heavy-up in periods where we think we've got good creative, and it's moving the needle for us. But over the long-term, we expect that we would have leverage there too. We'll hit a level of spending that we think is the right level in a market, and we'll hit the number of markets that we think we should be in, and then our business should continue to grow faster than our spend would.

So then the biggest expense is also the biggest barrier, that's the online advertising. We're very pleased with what we've seen with the efficiency over the last couple of quarters, but we've had three years before that of seeing pressure on that metric and pressure on ROIs year-over-year. So it's difficult to predict what will happen there for the future.

I have great confidence that we're probably better positioned than anybody else in the market with the most choices to try and convert that paid traffic into a booking on the best websites, the best converting websites from a desktop and mobile perspective, with the most clever advertising teams really tailoring our bidding approach, and using best-in-class tools to make sure we spend our money efficiently. I like our competitive hand there, but I think that it's very difficult to predict exactly how it's going to play out in the future. We have a couple of good quarters in the books there.

Mike Olson (Analyst - Piper Jaffray):

Thank you.

Dan Finnegan (CFO):

You're welcome.

Operator:

Mark Mahaney with RBC Capital Markets.

Mark Mahaney (Analyst - RBC):

Let me try two questions, please. Booking.com for business. It's something that seems to be, you've had it for a while, but you maybe have emphasized it a little bit more these last two quarters, so could you talk about the growth strategy there and how material that is to business today.

And then secondly the China outbound market, I know you called out Chinese New Year for Q1, and I know this is still a relatively small part of your business, but could you also talk about the materiality there, and anything unusual you're seeing in terms of growth of that segment, particularly the China outbound market in thank you.

Darren Huston (CEO):

Okay. Thanks a lot, Mark. So Booking.com for business, it's worth just giving people a little bit of background. So, our site has primarily been targeted at leisure. Over time, we've seen more customers come in for business purposes. And that's when we started to make some changes to our site, and see if we could get positive conversion, and those seemed to work.

Now, you can go onto our site and say am I traveling for leisure or business. If you pick business, we highlight things important to business people, and they seem to like that.

We've also discovered that about 20% of our business is business bookings versus leisure bookings. And the thesis, of course, is that nobody really knows, but maybe half of travel is business. It could be more or less than that, but that points to a pretty big opportunity if we serve that customer well.

So then, secondly, we built a very simple tool that allows assistants to book for business people. It allows you to track budgets. It allows a manager to track where all their people are from a care-of-duty perspective, and now we're also optimizing that tool.

We are seeing that our business bookings are growing faster than our leisure bookings which means they're taking share on the site. That's what we want to see. But it's a process of optimization and investment, and obviously, if you just think of the sheer size of the numbers, going from 20 to 50, for instance, that's a huge opportunity. But we're approaching it in a very typical Booking.com, Priceline Group way, which is many small steps, lots of optimization, and we're feeling positive.

I think it will be one of those things that continues to contribute. There's no massive revolutionary move, but more an evolutionary optimization, and to date feeling great about the progress but a lot more to do.

Your second question, China outbound. Some of it's hard to pick through because of Chinese New Year. It's just such a big holiday, and you guys have seen the pictures on the Internet and the train stations full of hundreds of thousands of people.

It was another great Chinese New Year, but the real question is where do things swing out. We did see, let's say, a little bit of softness. Now, with China, softness is all relative, it's still a fast growing market, but a little bit of softness in outbound in kind of Q3, Q4, A strong Chinese New Year, and then we have to see from there where it goes.

Obviously the situation in China, and the headlines can also rattle travelers. We haven't seen any large material effect. I also believe our long-term thesis around China certainly hasn't changed. They are the world's largest outbound travelers, and we're going to continue to try to take a bigger share of that business going forward.

Mark Mahaney (Analyst - RBC):

Thank you, Darren.

Operator:

Heath Terry with Goldman Sachs .

Heath Terry (Analyst - Goldman Sachs):

, Great. Thanks. I know chain hotels are a much smaller part of your mix, but Hilton, in particular, has been kind of vocal over the last few months about ending last room night availability and MF in pricing, and they now seem to be getting pretty aggressive in marketing their channels against the OTAs. What do you believe is driving these efforts, and are you seeing any other chains beginning to make similar moves?

Darren Huston (CEO):

Thanks, Heath. As you point out, depending on what you call a chain, 10% to 15% of our business is a combination of global and regional chains, and we're always in contract negotiations with the chains.

In fact, our take rate is quite stable. With many chains, we never had last room availability, but over time they've given us more availability partly because it's good business. We bring in a transient traveler. Very few of our travelers stay at the same hotel twice. And this is valuable business because it's incremental.

I think what you're seeing is discomfort with, maybe, the way the world is changing, but you should know our relationships are quite tight. There's also a difference between the chain and the owner of the hotel. The owner of the hotel wants more of this kind of business, and most of them want to lean into our model.

For me, the average chain hotel only gets about half of the business that should be coming to it, partly because of all of these restrictions that are put on it, but many chain owners are also agitating to make sure they get their fair share, because the business they're not getting is either going to another chain or it's going to an independent hotel.

So I don't appreciate some of the actions that get taken at the chain level at times, but our relationships on a day-to-day basis are actually quite constructive and cordial, and our chain business is actually quite healthy. They have great product. Our customers want the product.

But most of our customers, when they come to Washington, DC, for instance, they're not looking for the Hilton or the Marriott in Washington. They're looking for a great bed in Washington. And our ranking system presents to them businesses well priced, and if the product is not well priced or it's not available, it's not going to convert, and therefore it won't be presented to the customer. That's basically the way it works. I'm always hopeful we can work through many of these issues when they arise.

Heath Terry (Analyst - Goldman Sachs):

Great. Thanks, Darren. Appreciate the color.

Operator:

Justin Post with Bank of America -Merrill Lynch.

Justin Post (Analyst - BoA Merrill Lynch):

Thank you. Darren, maybe you could comment a little bit about your philosophy on vacation rentals charging the owner as opposed to the renter. Obviously, one of your competitors is going through a transition, why you like that business model.

Dan, could you quantify at all the Paris impact in Q4, and maybe the Easter impact in Q1, and then Europe really had some good RevPAR over the summer last year. I know you won't guide 2Q or 3Q, but how do you think about those comps in Europe as you approach this summer? Thank you.

Darren Huston (CEO):

Thanks, Justin. Our model, part of the reason we get to our model is we default to it. That's the way our entire business works. If the you look at our take rate in vacation rentals where we are charging the vacation rental owner, and HomeAway or Airbnb will charge a lot to the consumer, the take rates are actually quite equivalent, when you look at the total take rate.

I think anyone would rather charge to the owner, but if you don't have it instantly verifiable deal, then you might be worried that the owner's going to say, well, the person never showed up or he didn't stay or we didn't close the transaction. We're actually in an enviable position to be able to do it the way we do.

Obviously, I don't think I've ever met a consumer who likes to pay fees, and we're betting that consumers won't want to pay fees, but more importantly what we're trying to do is make booking a vacation rental or a home or an apartment as easy as booking a hotel room with the same level of trust, with the same feeling like you're going to get what you pay for. There's no post negotiation on price, which happens sometimes on an on-request model. There's no post negotiation. Maybe I want you to stay. Actually my room's not available now.

And I believe that's where the model will ultimately end up, getting from where we are today to where we need to, there's certainly still a lot of friction, but we're finding pretty positive response to this model. It also, I think, is a nice way to set expectations with both the booker and the place that they're booking, and so we're sticking with that model. It seems to be working for us. But still a lot of work to do, but we're playing sort of a long game here that I think more experience centric, friction free models are the future versus how the business is being done today.

Dan Finnegan (CFO):

And then your other question, Justin. So Paris impact, I did say in my prepared remarks that we saw about two or three weeks after the attack where our global room night growth rate dropped by more than 10 percentage points. That was a combination of less people booking and significant increase in cancellations of bookings that were already in our system.

But then such a solid bounce back in December, and such a great quarter overall from a top line and bottom line perspective that we didn't go and try to quantify any kind of an EBITDA impact to report to you. I don't feel like there's really anything to explain there. So I feel good with the quarter that we delivered despite the impact.

For Easter, we don't have a number there either. There's a lot of travel that happens right around Easter. We expect that will move from Q2 last year into Q1. But there are other breaks that people get that are just kind of around the time of Easter, or I know for my kids our break is still going to be in April this year. I don't know that we could precisely quantify for you the exact impact there. But it is beneficial to revenue in Q1 and will be a little bit of a detriment to revenue in Q2.

From a gross profit perspective, sorry, gross bookings perspective, it's probably a little bit net negative to Q1 in that during that period where people are traveling, the bookings really drop off to a lower level, because they're not booking while they're traveling. So that is the way to think about that in terms of gross bookings.

And then summer comps, yes, it was a very strong summer season for us. It's too early to predict now. We're not giving guidance for summer, but we said in our prepared remarks, we feel pretty good about the macro travel environment right now and hope that will continue into the summer, and paired with lower fuel prices, lower airline ticket prices, hopefully mean some good tailwinds for summer travel.

Justin Post (Analyst - BoA Merrill Lynch):

Great. Thank you.

Dan Finnegan (CFO):

You're welcome.

Operator:

Douglas Anmuth with JPMorgan .

Douglas Anmuth (Analyst - JPMorgan):

Thanks for taking the question. Just wanted to go back, Dan, to the comments, kind of post Paris, and the 10 points of impact that you mentioned, and just, in particular, was there something that you can point out that drove such a strong bounce back in terms of business, and was there anything that you guys did marketing or promotion-wise that really contributed there?

And then secondly, if you could give us an update on the booking suite business as well. Thanks.

Dan Finnegan (CFO):

In terms of Paris there was nothing, our approach with advertising, day-in and day-out is very consistent. So we're looking to generate as much business as we can at a reasonable ROI, and we didn't change anything that caused the trajectory of the business to change. That was consistent.

I think it's just amazing the resilience of people that even though a horrific event like those attacks in Paris, in a relatively short amount of time, people became comfortable again with the idea of traveling. Paris still isn't back to where it was pre-attack for us as a share of our business, but has bounced back from where it was.

And so I think we benefit, also, from being a global player with so many different choices where people can travel to that if they're not comfortable with a particular destination they can find other places where they may feel more comfortable with traveling. So really just the resilience would be the one thing that we'd point to that, thank God there were no additional attacks, so the business bounced back.

Darren Huston (CEO):

And just on BookingSuite, we feel really good about the business. We don't have any numbers to share for basic competitive reasons, but we built up the team. We added a new product, price match.

It's a revenue management, cloud based tool in 2015 which has been a nice addition. But generally the demand for the product is very high, and it's been as much an issue of how do we fulfill demand for the team. I'm proud of where it's at, and we hope 2016 will be another big year for BookingSuite.

Douglas Anmuth (Analyst - JPMorgan):

Thank you both.

Operator:

Ken Sena with Evercore Partners .

Ken Sena (Analyst - Evercore Partners):

Can you, in terms of the bookings acceleration, talk a little bit more maybe about the vacation rental contribution and maybe the opportunity there. And then anything on the hotel room night side, also.

And then, you mentioned that IB or TripAdvisor won't offer significant impact to the top line or add efficiency. Can you expand on that a bit from a branding standpoint and how satisfied you are with the partnership right now or the product. Thank you.

Darren Huston (CEO):

I think I can take both of those, Ken. Well, on vacation rentals, generally, I would say self-catered product, as well is what we call, so this includes apartments and homes and apart-hotels. That part of the market has traditionally had a lot more friction in it than the hotel booking side, and as that friction gets removed, you begin to see growth.

Certainly there's this sort of Airbnb effect of this being a new way to travel, but more importantly, for large groups, families, booking a self-catered product or a home is actually a really good deal, the price value equation looks great. But, it's always had all kinds of friction around, is it going to be there, where does my money go, they want a deposit, et cetera, et cetera.

As we remove those points of friction, we're seeing good growth in that area. I don't have any numbers to share, but that space is growing faster than our core business which is what you would hope. And we feel like we have plenty of demand as we get ready supply to fill those rooms with guests who are looking for them.

The other question was on Instant Book. Yes, you know, it's still very early days, but we're happy with the way that TripAdvisor has fulfilled their side of the deal. The branding looks great. It seems to, particularly in the US market, where the early roll-out has been, where the Booking.com brand is not as strong, I think that's helped us a lot.

They're now rolling out into markets maybe where we're stronger, maybe we'll help them a bit where our brand might even be stronger than TripAdvisor's. I think from a mutual perspective, it's been positive. There's a lot yet to optimize, but we sort of think about it as, wow we've got an ad and we have a performance tool to drive more business, and that's always a real positive thing for the company. I'm still, by the way, optimistic, still very supportive, and let's see where things end up as Steve and his team get to roll this product out to more markets.

Ken Sena (Analyst - Evercore Partners):

Thank you very much.

Operator:

Lloyd Walmsley with Deutsche Bank.

Lloyd Walmsley (Analyst - Deutsche Bank):

Thanks for taking the questions. Two if I can.

First, there's been a lot of changes in rate parody regulations in France and Germany, and wondering if you guys are seeing any discernable trends in how hotels in France may be responding to the Macron law, how it's impacting conversion and how you think this ultimately plays out in the EU.

And then second question, similar. The innovation box tax regime in the Netherlands seems like it's in a bit of flux. Can you just give us kind of a sense of how much of your pretax income flows through at the reduced tax rate, and how you think either rates or the magnitude of the shield are likely to change over the next few years, or perhaps maybe grandfathering gives you a long period of time before you see this, any comments on either of those.

Darren Huston (CEO):

Okay. I'll take the first one, Dan you take the second. We haven't seen any major impact, but it's been a great experimental bed, and I think one of the biggest learnings, and I had mentioned this in a previous comment, is customers aren't going to overpay for product. So the properties are free to price the product the way they want to price it, but if it's overpriced, then it won't convert, and then they don't get any business.

In a way, the marketplace has this self actualization to it, regardless of what the rules are. We still believe parody is a very important construct. We think it frankly offers a lot of opportunity also for the properties to have a level playing field so that we're not using our margins to undercut them.

I'm now more comfortable with any regime. People realize if you want to get bookings on booking, you have to have a well priced product. And the marketplace deals with that, and if you don't, then nothing sells. Conversion goes down. Your ranking goes down, and then you don't get any business.

So it's been interesting. All of our checks would say that parody in France is, at least, if not more, healthy than most of our markets in the world. And I think that's overall good news.

Dan Finnegan (CFO):

Lloyd, on your second question, innovation box. The 10-K will be out shortly and quantifies that exactly, so I'm going to leave it to the 10-K to take care of that one for you. It's a significant benefit for us as you point out.

We have a risk factor in our 10-K that I'll also point you to that clearly delineates what we see as the risks related to the innovation box. We need to continue to qualify as being innovative, and we need to receive extensions from Dutch tax authorities.

We've done well with that since the advent of the innovation box, so I feel confident there. And then there's also developments at the OECD, the Organization of Economic Cooperation and Development, where they're looking to harmonize tax treatment across European Union, and one of the things that they're taking into consideration is these innovation box type regimes, and they've talked about doing away with them sometime in 2021.

So that's certainly a risk out there. 2021 is still a long way away, and tax is subject to change. Rates could change, and the OECD's interpretations could change. So those are the things that you should look to and again, I would refer you to the specific wording in the 10-K.

Lloyd Walmsley (Analyst - Deutsche Bank):

Thanks, guys.

Dan Finnegan (CFO):

You're welcome.

Operator:

Peter Stabler with Wells Fargo Securities.

Peter Stabler (Analyst - Wells Fargo):

Good morning. Thanks for taking the questions. A couple quick ones.

First, regarding the bidding program that allows your hotel partners to improve their ranking and their results, wondering if you could comment on the appetite you're seeing for that in the market. And is participation large enough here to impact blended take rates, or is it really kind of a non-material service offering that you're presenting to the market?

Secondly, quickly, any expectation for negative impact due to Zika virus fears? Thanks.

Darren Huston (CEO):

Okay, Peter. The first one I'll take. First of all, it's important to understand how the ranking algorithm works. The primary driver of how things get ranked is conversion.

It really is consumer interest, and you always have to be very careful in how you balance monetization with consumer interest, because if you overweight on monetization, you can have a really poor quality result. No one wants to come to your website.

So, at least the way we've done it in the past, is we have standard hotels and preferred hotels. And preferred hotels are only allowed to become preferred if they meet a number of experience criteria, and then they pay us a slightly higher commission and can often as much as double their bookings by being preferred. That's been our primary driver.

The second one, we do allow some overrides. They're not used broadly. A hotel can pay us even more commission, if they want, say it's a new hotel, they don't have a lot of reviews or something to try and get a slightly higher ranking, but we never allow them ultimately to buy the very top of the ranking from the very bottom. It doesn't work that way.

So we feel comfortable with the model that we have. I think it's a very, like in any auction site, you have to be really careful with this dial, because you think you might win in monetization, but if you crap up the product, then you're not going to have any customers. That's the way I think about it.

Your next question was, Dan, do you want to take Zika.

Dan Finnegan (CFO):

Zika virus, Peter, thus far, we haven't seen a significant impact. Most of the travel within Southern hemisphere is from other destinations in Southern hemisphere, so it's generally people traveling from an area that's been impacted to another area that's impacted, and so we haven't seen it as deterring travel. We don't want to predict what the impact could be for the future, but that's been the impact to date.

Peter Stabler (Analyst - Wells Fargo):

Thanks so much.

Dan Finnegan (CFO):

You're welcome.

Operator:

Thank you. This concludes the Q&A session. I'll now turn the call back over to Darren Huston.

Darren Huston (CEO):

I guess just in conclusion, we're really pleased with the quarter. I hope you are.

It's nice to enter the year where we're growing faster than when we entered the year at our size and scale. We always are facing the law of large numbers, but a big thanks to all of our people and mostly just great execution and seeing a lot of growth initiatives begin to pay off is a great feeling. So thanks all for joining the call, and we'll see you next quarter.

Operator:

Ladies and gentlemen, this concludes today's conference. T