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Research Update:

Expedia Group Inc. Upgraded To 'BBB' On Strong Operating Performance; Outlook Stable

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Table Of Contents

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Overview

- U.S. online travel agency (OTA) Expedia Group Inc.'s adjusted net debt leverage fell to 0.6x at March 31, 2018 from strong revenue growth and good cash flow generation.
- Significant growth in revenue, surplus cash balances, and its platform scale over the last three to four years position the company for continued growth.
- We are raising our ratings on Expedia, including our corporate credit rating, to 'BBB' from 'BBB-'.
- The stable rating outlook reflects our expectation that Expedia will generate high-single-digit to low-double-digit percentage revenue growth and maintain adjusted net debt leverage comfortably below 1.5x over the next 12 to 24 months. Additionally, we expect the company will successfully execute on its cloud migration, grow its alternative accommodation, corporate travel, and advertising businesses, and maintain its leadership position in the market.

Rating Action

On June 26, 2018, S&P Global Ratings raised its corporate credit rating on Bellevue, Wash.-based Expedia Group, Inc. to 'BBB' from 'BBB-'. The rating outlook is stable.

At the same time, we raised our issue-level rating on Expedia's unsecured notes to 'BBB' from 'BBB-'.

Rationale

Our rating upgrade is based on several factors, including our reassessment of the longer-term sustainability of Expedia's market position given the significant growth in surplus cash balances, revenue, cash flow, and platform scale over the last three to four years; its good credit metrics with adjusted debt to EBITDA declining to 0.6x at March 31, 2018, from 0.8x a year ago; and its good growth potential in alternative accommodation, corporate travel, and advertising. The company's financial position continues to improve and its cash and cash equivalents now exceed its funded debt level. Recent U.S. tax reform also reduces the company's tax rate and enables the company to efficiently repatriate cash to the U.S.

Our corporate credit rating on Expedia reflects its significant negotiation leverage given is meaningful scale and market position as one of the largest global OTA; good brand awareness and diversity across metasearch, OTA, and alternative booking; and low leverage. The rating also reflects its low EBITDA margins, less financial flexibility, and higher revenue concentration in the mature U.S. market compared to large industry peers. Increased metasearch or hotel bookings disintermediation by Google, competitive threats and margin from existing and new entrants and higher marketing costs, and improved hotel and airline direct booking effectiveness remain the key business risks.

Expedia is one the largest OTAs globally. The company operates through a number of different brands, including Brand Expedia, Hotels.com, Hotwire.com, Trivago, Travelocity, Orbitz, and HomeAway. Expedia's adjusted EBITDA margin has been under pressure due to higher investment costs and lower commission rates and it is below that of its rated peers. The company's EBITDA margin declined to 12.6% for the 12 months ended March 31, 2018, from 15.3% a year earlier due to significant investments in its cloud migration and increased marketing spending and investments in many of its brand, especially HomeAway and Trivago. We expect Expedia's EBITDA margin will improve slightly through 2018 and 2019 and return to historical levels, above 15% by 2020 after the cloud investments are fully complete and Egencia, HomeAway, and Trivago begin to enjoy benefit from scale and past investments.

Booking Holdings Inc., Expedia Group Inc., Alphabet Inc., Tripadvisor Inc. (unrated), Airbnb Inc. (unrated), Trivago N.V. (majority owned by Expedia), and Ctrip.com International Ltd. (unrated) are the major competitors in the online travel industry. Booking and Expedia are the largest OTAs and offer consumers similar experiences, information, and capabilities. Brand awareness, user experience, the depth and breadth of bookable properties and user reviews, and user acquisition and marketing spending efficiency are key competitive factors. Expedia's revenue mix is skewed toward the less profitable airline bookings, U.S. hotel reservations, and metasearch listings. Expedia benefits from its presence in corporate travel and the increasing popularity of its rewards program, which should support lower customer acquisition costs. Additionally, we expect Expedia's margins to eventually benefit from its shifting attention to secondary and tertiary markets in Europe and alternative accommodations. However, we believe it will take time and meaningful financial investments to increase its critical mass in these markets. Booking's profits are concentrated outside the U.S. in its booking.com brand. The company benefits from more than twice the number of bookable properties, better global revenue diversification, and higher margins due to its strong network of hotel partners. Google has an important position in the industry as both a key business partner to drive consumer acquisition and a significant competitor within metasearch and bookings (Google Flights and Hotel Ads). Despite the substantial amount of revenue generated from OTAs and the risk of increased regulatory scrutiny over search listings, we expect Google to continue to expand its presence within the industry. However, we believe Booking and Expedia are not as vulnerable as they were three to four years ago. Their large scale, good brand awareness, high volume of organic traffic, broader range of consumer services, and improved financial flexibility have, in our opinion, improved their business model defensibility.

Consumer preferences for online travel search and online booking of travel services as well as good global economic and personal income growth have fueled Booking's growth. Additionally, easier access to information via smartphones and mobile apps has encouraged price-shopping behavior, which benefits OTAs. The relationship between OTAs and their airline and hotel partners can often be strained, but OTAs provide a valuable marketing service to their partners by delivering large volumes of cost-conscious customers. Given our expectation for strong underlying long-term growth fundamentals for the global travel industry and consumer preference for online travel search, we believe OTAs have the ability to increase their market share and expect that large OTAs with significant marketing and technology investment budgets will continue to increase revenue at double-digit percentage rates over the next two to three years. We believe increased travel volumes will more than offset any negative commission pressure and expect online travel booking volume to increase over the next several years, especially in Europe and Southeast Asia, which lags the mature North America market. Historically, difficult economic times have encouraged price-shopping behavior, which disproportionately benefits OTAs. Longer term, we believe OTAs have the ability to enhance their competitive position if they are able to leverage their large data repositories and new technology innovations--such as machine learning and data science analytics--to personalize the user booking customer journey and experience, and enhance the traveling experience.

Our rating also reflects our expectations that adjusted net debt leverage will remain below 1x and adjusted free operating cash flow (FOCF) to debt will be in the high-40% area over the next two years. The company generates about $1 billion annually of FOCF, and has good surplus cash balances. Over the next two years we believe the company will continue to invest in its HomeAway, Egencia, and Trivago brands and that its EBITDA margins will remain narrow. We also incorporate our expectation for leverage volatility due to competitive threats or acquisition or investment needs to address changing consumer preferences.

Our base case assumes the following:

- U.S. GDP growth of 2.9% in 2018 and 2.6% in 2019, and Eurozone GDP growth of 2.3% in 2018 and 1.9% in 2019. Revenue growth will significantly outpace GDP growth as the company benefits from the secular trend of bookings moving online from offline and a large fragmented market in which the company continues to gain market share;
- Low-double-digit percentage revenue growth to about $11.1 billion in 2018 and $12.4 billion in 2019
- EBITDA margin remains pressured at about 12% to 13% over the next two years due to investments;
- Adjusted net debt at $2 billion in 2018, which includes $721 million of our operating lease, accrued interest, and tax adjustments. Our

adjustments also reflect a net debt of about 95% of our forecasted cash balances;

- Capital expenditure needs of about $700 million to $800 million annually; and
- Tuck-in acquisitions funded with discretionary cash flow and revolver availability (unlikely to result in adjusted net debt leverage increasing above 1.5x).

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA remaining below 1x in 2018 and 2019; and
- Discretionary cash flow to debt in the 38% to 40% area in 2018 and 2019.

Liquidity

We expect Expedia's liquidity to be strong over the next 12 to 24 months. We forecast sources will far exceed uses (greater than 12x) and will remain positive even if EBITDA unexpectedly declines by 30%. The company has over $4.45 billion of surplus cash on its balance sheet and generates more than $1 billion in FOCF annually. Accordingly, it has the ability to absorb high-impact, low-probability events without refinancing. The company's cash balances exceed its funded debt, supporting our view that the company has a sound relationship with banks and satisfactory standing in credit markets.

As of March 31, 2018, principal liquidity sources include:

- Cash and cash equivalents of $4.5 billion;
- Full availability under its new $2 billion revolving credit facility; and
- Expected cash flow from operating activities between $1.2 billion-$1.4 billion annually in 2018 and 2019.

Principal liquidity uses include:

- Annual capital expenditures (capex) of $700 million-$800 million in 2018 and 2019;
- Dividends of about $175 million in 2018; and
- The company has minimal maturities over the next 12 to 24 months.

Outlook

The stable rating outlook reflects our expectation that Expedia will generate high-single-digit to low-double-digit percentage revenue growth and maintain adjusted net debt adjusted net debt leverage comfortably below 1.5x over the next 12 to 24 months. Additionally, we expect the company will continue to successfully execute on its cloud migration and grow its alternative accommodation, corporate travel, and advertising businesses and maintain its leadership position.

Downside scenario

The most likely causes of a lower rating would be the company adopting a more aggressive financial policy, its inability to effectively respond to changes to the competitive landscape or consumer preferences, or a significant increasing in its share repurchases or product development spending such that adjusted net debt leverage rises above 1.5x on a sustained basis. Alternatively, a significant loss of market share caused by increased competition from Google or other competitors, resulting in EBITDA margins declining by about 100-200 basis points could cause us to downgrade the company.

Upside scenario

Although unlikely over the next 12 to 24 months, we could raise the rating if Expedia's surplus cash balances rise substantially while the company continues to gain market share and expands EBITDA margin by about 200-300 basis points. In this scenario the company would broaden its revenue and earnings diversity by growing HomeAway and Egencia and sustaining debt to EBITDA of well below 1.0x over our two-year forecast period.

Ratings Score Snapshot

Corporate credit rating: BBB/Stable/--

Business risk: Satisfactory
- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest
- Cash flow/leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Comparative rating analysis: Negative (-1)

Issue Ratings--Subordination Risk Analysis

Capital structure

Expedia's capital structure consists of senior unsecured notes issued by Expedia Group Inc., which is the publicly listed parent company. Expedia weighted-average remaining debt term extends about eight years. We expect that Expedia will refinance or repay its upcoming debt maturities proactively.

Analytical conclusions

We rate Expedia senior unsecured debt 'BBB', in line with the issuer credit rating, since no significant elements of subordination risk are present in the capital structure.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Media And Entertainment Industry, Dec. 24, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Expedia Group, Inc.		
Corporate Credit Rating	BBB/Stable/--	BBB-/Stable/--
Senior Unsecured	BBB	BBB-