

McIntire Investment Institute

At the University of Virginia



Priceline.com
(NASDAQ: PCLN)

priceline™
Name Your Own Price™

Prepared by Hideyuki Liu | 1 October 2010



Business Overview

Founded in 1997

Headquartered in Norwalk, CT

Online travel service

- 29 languages in 78 countries
- Europe, North America, Asia, the Middle East, and Africa
- Booking.com, priceline.com, agoda.com

Name Your Own Price



Business Overview

- Provides travel brokerage services to consumers
- Aggregates prices for flights, hotels, car rentals
 - Makes finding cheap prices easy
- Name Your Own Price
 - Place bid for hotel fare you are willing to pay, and hotels either accept or reject
- Direct competitors:
 - Expedia
 - Travelocity
 - Orbitz



Stock Summary

2-Year Stock Chart



Basic Stock Information

Share Price: \$349.93

Market Capitalization: \$16.93B

P/E: 30.99

EPS: \$11.29

52-Week Range: \$154.12 - \$358.24

Average Volume (3 Month): 1.06M

Total Cash: \$356MM

Total Debt: \$508MM

PCLN is an impending Short

1) Minimal barriers to entry = cut-throat competition

2) New industry entrants like Kayak.com

3) Strong performance belie severe headwinds

4) Low brand loyalty (VAR)

5) Name Your Own Price: a double-edged sword



No barriers to entry

“The barriers to enter the online travel market are becoming increasing low. There are a plethora of online travel sites such as Kayak.com, Expedia.com, Orbitz.com, TripAdvisor.com, each of which boast more than 5 million visitors to their website each month.”



“Google has recently entered the travel space with their \$1 billion acquisition of online travel data warehouse ITA Software.”

PCLN's services are not differentiable

flights hotels cars vacations cruises

package and save up to \$500:

- flight only
- flight + hotel
- flight + hotel + car

NO BOOKING FEES + EARN AIRLINE MILES
on published price flights [details](#)

my recent searches
CHO to BOS, 10/21 - 10/24 [go](#)

from (city or airport) to (city or airport)
CHO BOS

departing returning
10/21/2010 10/24/2010

i'm flying one-way

passengers
(18+ years) (2-17 years)
1 Adult 0 Child

priceline.com
Name Your Own Price™

[search now!](#)

Round-trip One-way Multi-city

From City name or [airport](#) To City name or [airport](#)

Leave Return
mm/dd/yy mm/dd/yy

Anytime Anytime

Travelers [\(Children or seniors?\)](#)
Adult (18-64)
1

Flight preference

ORBITZ

[Find Flights](#)
[Find Flight + Hotel](#)

- Flight
- Hotel
- Car
- Cruise
- Activities
- Flight + Hotel
- Flight + Car
- Flight + Hotel + Car
- Hotel + Car

Book FLIGHT + HOTEL SAVE UP TO \$450*
[Learn more](#)

Roundtrip One way Multiple destinations

My dates are flexible (popular US routes only)

Leaving from: Going to:
Charlottesville, VA (CHO-Charlottesville-A) Boston, MA (BOS-Logan Intl.)

Departing: Time: Returning: Time:
10/21/2010 Anytime 10/24/2010 Anytime

Adults (19-64): Seniors (65+): Children (0-18):
0 0

Expedia

[SEARCH FOR FLIGHTS](#)
[SEARCH FOR FLIGHT + HOTEL](#)

Save with Packages... Pick Locations & Dates... Add Traveler Info...

- Flight + Hotel
- Flight + Hotel + Car
- Hotel + Car
- Last Minute Packages

From To

Exact Dates
+/- One to Three Days
My Dates are Flexible

Depart mm/dd/yyyy Anytir

1 mm/dd/yyyy Anytir

Adults (18-64) Minors (2-17) Seniors (65+)
Total 1 0 0

travelocity

[Search](#)



PCLN's services are not differentiable (JFK-LAX)

 Delta Airlines	 American Airlines	 JetBlue Airways	 US Airways
\$278 total \$299	\$278 total \$299	\$278 total \$299	\$278 total \$308
\$278 total \$299	\$278 total \$299	\$278 total \$299	\$507 total \$528

priceline.com
Name Your Own Price™

Find flights by:				jetBlue	
Airline	Stops	American Airlines	Delta Air Lines	JetBlue Airways	United Airlines
Non-stop		\$278 total \$299	\$278 total \$299	\$278 total \$299	\$287 total \$316
1 stop		\$278 total \$310	\$278 total \$310	\$430 total \$462	\$297 total \$330

ORBITZ

				jetBlue Airways JetBlue Airways
Nonstop	from \$278 \$299 total see below	from \$278 \$299 total	from \$278 \$299 total	from \$278 \$299 total
1 stop	from \$278 \$308 total see below	---	from \$278 \$310 total	---


Expedia

Lowest Fare Summary	Non-Stops	All Flights
 Delta Air Lines	LOWEST FARE \$278 Total \$299	\$278 Total \$299
 JetBlue Airways	\$278 Total \$299	\$278 Total \$299
 American Airlines	\$278 Total \$299	\$278 Total \$299
 United	\$288 Total \$309	\$288 Total \$309

 **travelocity**



Low barriers to entry = cut-throat competition

20 | Escalation: Priceline answers the Travelocity and MAR | Expedia fee-cutting 2009

Posted by: Mark Ashley



The online travel agency battle royale is *on*. Just a few days after Travelocity and Expedia **eliminated their booking fees** for airline tickets, **Priceline**, the first agency to cut the fee, is fighting back with some copycatting of its own.

The agency is now offering price guarantees that mimic Orbitz' "Price Assurance" for airfare and Travelocity's "PriceGuardian" for packages:

That's why starting today [we're] backing up every Flight AND Vacation Package purchase with Free Pricedrop Protection for orders booked by June 1st. Now you, and your users, are automatically covered if prices drop before the trip!

Up to \$300 Cash Back if Flight Prices Drop:

If another priceline customer books the same flight for a lower price, we'll automatically refund the difference in cash...up to \$300.

Up to \$600 Cash Back if Vacation Package Prices Drop:

If another priceline customer books the same vacation package for a lower price, we'll automatically refund the difference in cash...up to \$600.

New entrants undercut online travel brokerages



KAYAK™



Overvalued multiples ... overvalue company?



Ticker	PCLN	EXPE	OWW
Price (Close on Sep. 30)	348.13	28.41	6.27
Market Capitalization	16.88B	8.05B	650.56M
Enterprise Value	16.14B	7.85B	993.29M
52-week High	358.24	29.85	8.11
% of 52-week High	97.2%	95.2%	77.3%
EPS	11.29	1.34	-0.09
P/E	30.8	21.2	NA
EV/EBITDA	26.0	11.1	7.6
Sales (LTM)	2,624	3,102	743
Gross Profit (LTM)	1,494	2,460	598
% Margin	56.9%	79.3%	80.5%
Operating Profit (LTM)	580	670	56
% Margin	22.1%	21.6%	7.6%
EBITDA (LTM)	620	706	131
% Margin	23.6%	22.8%	17.6%
Net Income (LTM)	566	393	-7
% Margin	21.6%	12.7%	NA

PCLN's margins do not justify its earnings multiples

Implied Share Price		
Net Income	21.20x	\$239.35
EBITDA	9.35x	\$119.86
EBITDA	11.10x	\$129.89

Strong 2Q results belie severe headwinds

1) Revenues up 27% yoy, EBITDA up 54% yoy

2) Gross Profit Margin 58%, EBITDA Margin 24%

3) Net Income up 71% yoy

All signs point upward – or do they?



Extremely high expectations due upcoming 3Q

Financial Summary <i>(USD in millions)</i>	LTM 06/30/10	FYE 12/31/09	FYE 12/31/08	FYE 12/31/07	FYE 12/31/06	2Q 06/30/10	1Q 03/31/10	4Q 12/31/09	3Q 09/30/09	2Q 06/30/09	1Q 03/31/09	4Q 12/31/08	3Q 09/30/08	2Q 06/30/08	1Q 03/31/08
Revenue															
Merchant revenues	\$1,532.7	\$1,447.6	\$1,218.2	\$1,002.8	\$904.2	\$446.7	\$368.3	\$317.4	\$400.3	\$392.8	\$337.0	\$268.8	\$324.0	\$336.2	\$289.2
Agency revenues	1,074.4	868.4	648.8	398.2	213.9	317.5	213.2	220.5	323.2	204.5	120.2	133.0	232.6	173.2	109.9
Other revenues	17.2	22.2	17.9	8.3	5.0	3.3	2.9	3.9	7.2	6.4	4.8	4.3	5.0	4.5	4.1
Total revenues	\$2,624.2	\$2,338.2	\$1,884.8	\$1,409.4	\$1,123.1	\$767.4	\$584.4	\$541.8	\$730.7	\$603.7	\$462.1	\$406.0	\$561.6	\$514.0	\$403.2
Cost of revenues	1,112.7	1,077.4	928.8	770.0	722.0	322.2	265.3	228.6	296.7	298.5	253.7	201.0	245.5	260.3	222.1
Gross Profit	\$1,511.6	\$1,260.8	\$956.0	\$639.4	\$401.1	\$445.3	\$319.1	\$313.2	\$434.0	\$305.2	\$208.3	\$205.1	\$316.1	\$253.7	\$181.1
% Margin	57.6%	53.9%	50.7%	45.4%	35.7%	58.0%	54.6%	57.8%	59.4%	50.6%	45.1%	50.5%	56.3%	49.4%	44.9%
Operating Expenses															
Advertising - Offline	\$36.4	\$36.3	\$38.0	\$36.0	\$31.8	\$10.1	\$11.8	\$6.0	\$8.5	\$11.1	\$10.8	\$7.8	\$8.3	\$9.9	\$12.0
Advertising - Online	452.8	365.4	270.7	172.7	113.8	132.5	113.1	92.1	115.1	90.1	68.1	55.8	84.3	72.9	57.8
Sales and marketing	94.7	81.2	77.9	47.2	42.1	28.5	24.1	17.7	24.5	20.7	18.4	20.2	21.5	19.9	16.3
Personnel	208.4	180.2	163.8	103.0	79.4	62.9	49.8	44.8	51.0	44.9	39.5	42.0	45.3	39.6	36.9
SG&A	79.5	68.6	55.3	91.8	28.6	22.4	18.0	19.7	19.4	14.7	14.8	15.7	13.5	14.2	11.8
Information technology	19.4	19.1	18.0	13.8	9.7	4.9	4.6	5.1	4.8	4.7	4.5	4.3	4.4	5.1	4.1
Restructuring charge (n	-	-	-	-	0.1	-	-	-	-	-	-	-	-	-	-
D&A	40.6	39.2	42.8	37.1	33.4	10.8	9.8	10.0	10.1	9.7	9.4	10.4	10.9	11.1	10.4
Total	\$931.8	\$789.9	\$666.5	\$501.5	\$339.1	\$272.1	\$231.2	\$195.3	\$233.3	\$195.9	\$165.5	\$156.2	\$188.2	\$172.8	\$149.3
Operating Profit	\$579.7	\$470.8	\$289.5	\$137.9	\$62.0	\$173.2	\$87.9	\$117.9	\$200.8	\$109.4	\$42.8	\$48.8	\$127.9	\$81.0	\$31.8
D&A	40.6	39.2	42.8	37.1	33.4	10.8	9.8	10.0	10.1	9.7	9.4	10.4	10.9	11.1	10.4
EBITDA	\$620.4	\$510.0	\$332.3	\$175.0	\$95.4	\$184.0	\$97.7	\$127.9	\$210.9	\$119.1	\$52.2	\$59.3	\$138.9	\$92.0	\$42.1
% Margin	23.6%	21.8%	17.6%	12.4%	8.5%	24.0%	16.7%	23.6%	28.9%	19.7%	11.3%	14.6%	24.7%	17.9%	10.4%

**Upcoming 3Q has traditionally been their best quarter,
But can they outperform an all-time best quarter?**



Airlines' 2010 success not sustainable

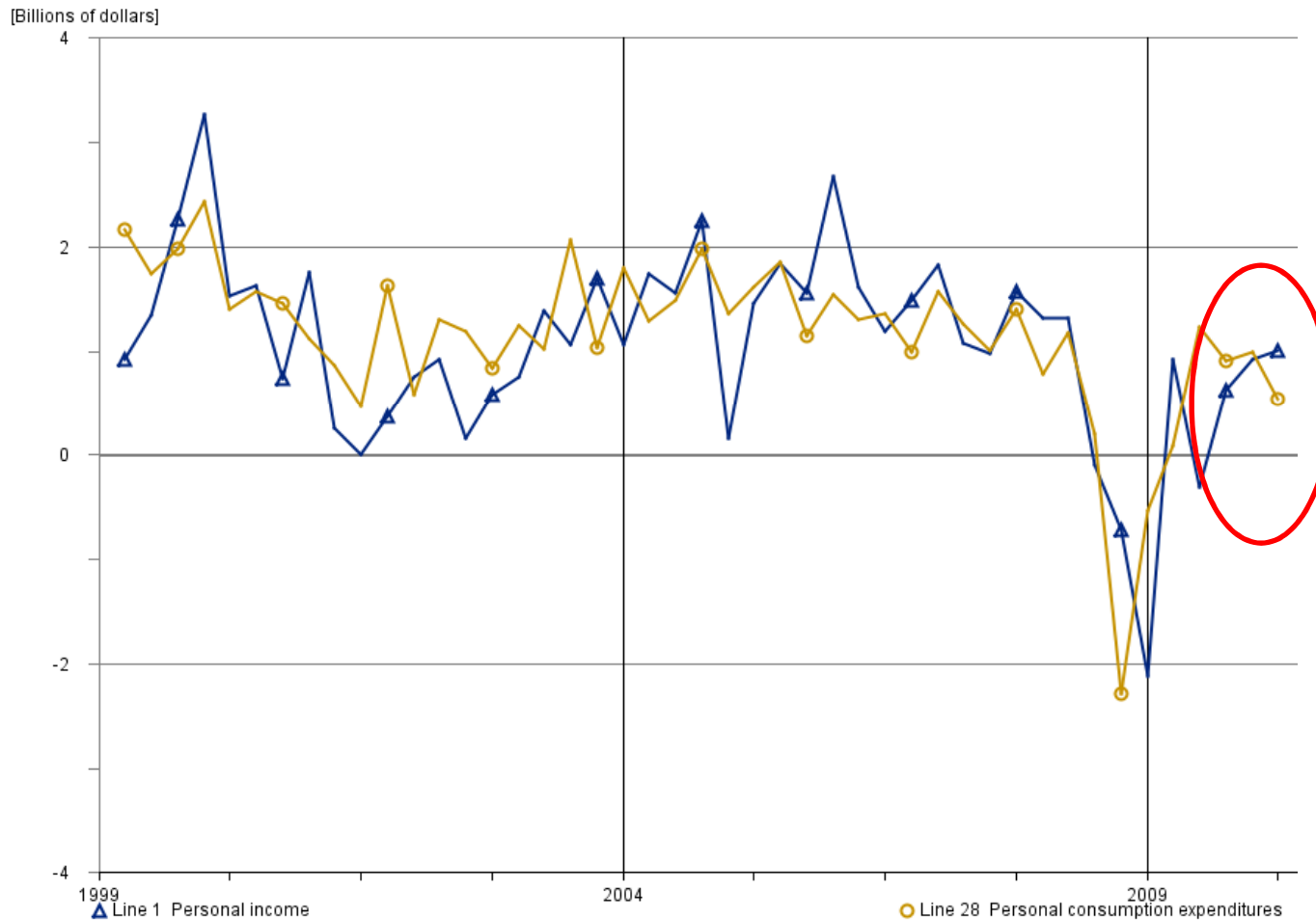
- 2010 expected to be the first profitable year for airlines in a while
 - \$8.9 billion for overall industry
- However, industry earnings are expected to decline by 40% in 2011 as demand does not meet capacity



Source: International Air Transport Association

US consumer down – and not spending

Table 2.1. Personal Income and Its Disposition



- In 2010, US personal income has recovered but spending keeps falling

- Income going towards savings

- Business travel slightly recovering, but businesses don't use priceline.com

Europe in shambles...



- PIIGS in crisis
- Germany and France having to deal with subsidizing and rescuing weak countries

Over two-thirds of the total world economy is experiencing weakness, which means an extremely difficult environment for PCLN

Insiders selling out of PCLN

Net Share Purchase Activity

Insider Purchases - Last 6 Months

	Shares	Transactions
Purchases	N/A	0
Sales	238,376	12
Net Shares Purchased (Sold)	(238,376)	12
Total Insider Shares Held	453.39K	N/A
% Net Shares Purchased (Sold)	-34.50%	N/A

Insider Transactions Reported - Last Two Years

Date	Insider	Shares	Type	Value*
20-Sep-10	MYLOD ROBERT J J Officer	2,000	Direct	\$6,900,002
1-Sep-10	MYLOD ROBERT J J Officer	14,000	Direct	\$41,360,002
23-Aug-10	MILLONES PETER J Officer	6,000	Direct	\$18,160,002
20-Aug-10	MYLOD ROBERT J J Officer	2,000	Direct	\$5,990,002
1-Jun-10	MYLOD ROBERT J J Officer	14,000	Direct	\$26,720,002
24-May-10	EPSTEIN JEFFREY E Director	3,333	Direct	\$6,480,002
12-May-10	RYDIN CRAIG W Director	10,500	Direct	\$23,060,002
12-May-10	BOYD JEFFERY H Officer	105,554	Direct	\$229,520,002



Low brand loyalty (VAR)

Do you search multiple sites when booking a trip or do you always return to a favorite site? If you have a favorite site, which site is it?	
Number and Response Text	Number and Response Text
1 Multiple sites	42 Kayak
2 Multiple sites	43 Multiple, favorite is Farecast
3 Multiple sites	44 Usually use a specific hotel or airline website rather than booking sites
4 Multiple sites	45 Yes; Expedia
5 Kayak	46 Expedia
6 Multiple sites	47 Expedia
7 Orbitz	48 Expedia
8 Multiple sites	49 Multiple sites
9 Priceline.com	50 Multiple sites
10 Multiple sites	51 Multiple sites
11 Multiple sites	52 Expedia
12 Multiple sites	53 Multiple sites
13 Multiple sites	54 Kayak
14 Multiple sites	55 Multiple sites
15 Travelocity	56 Multiple sites
16 Multiple sites	57 Return to a favorite site--Expedia
17 Multiple sites	58 Multiple sites
18 Sometimes - usually Priceline	59 Favorite Site
19 Multiple sites	60 Kayak
20 Expedia	61 Multiple sites
21 Multiple sites	62 Multiple sites
22 www.wholesale-fares.com /travelling overseas	63 Multiple sites
23 Multiple sites	64 Multiple sites
24 Tripadvisor	65 Orbitz
25 Multiple sites	66 Multiple sites

26 Multiple sites	67 Multiple sites
27 Multiple sites	68 Multiple sites
28 Multiple but usually use Kayak	69 Multiple Sites
29 Multiple sites	70 Multiple sites
30 Multiple sites	71 Multiple sites
31 Expedia.com	72 Travelocity
32 Travelocity	73 Multiple sites
33 Multiple sites	74 Multiple sites
34 Multiple sites, Orbitz	75 Multiple sites
35 Compare Travelocity, Expedia, and Orbitz. Favorite: Expedia	76 Multiple sites
36 Travelocity	77 Multiple sites
37 Multiple sites	78 Multiple sites
38 Orbitz	79 Multiple sites
39 Multiple sites	80 Multiple sites
40 Travelocity	81 Travelocity
41 Multiple sites	82 Priceline.com

Source: Christina Polenta's Expedia (NASDAQ: EXPE) memo



Low brand loyalty (VAR)

Summary Statistics		
Response	Amount	%
Expedia	10	12%
Kayak	5	6%
Orbitz	4	5%
Priceline	3	4%
Travelocity	6	7%
Multiple sites	50	61%
Others	4	5%

There is no brand loyalty. The target customer responds mainly to low prices.



Name Your Own Price: a double-edged sword

The screenshot shows the priceline.com website interface. At the top, the priceline.com logo is visible on the left, and 'Flights | Hotels' is on the right. Below the logo, the search parameters are displayed: 'DEPARTURE » Tuesday, January 8, 2008' and 'Kansas City, MO (MCI) → Bangkok, Thailand (BKK)'. To the right of these parameters, 'RETURN' and 'Bangkok' are partially visible. The main content area is divided into three columns. The first column is a yellow box with a red banner that says 'SAVE UP TO 40% OFF' and 'Name Your Own Price®'. The second column features the Midwest Airlines logo and the text 'Midwest Airlines'. The third column features the Delta Airlines logo and the text 'Delta Airlines'. At the bottom of each column, there is a 'Lowest Price Flights' link with a right-pointing arrow, and the price 'from \$1340' is displayed below it.

The one way PCLN can differentiate itself. But its one advantage is also a significant disadvantage

Hotel supply rapidly dropping

- Name Your Own Price thrives off of excess vacancies in hotels
 - Hotels that need to fill space will sell rooms at low price to recover some costs
- But there has been an excess supply of hotels, and now they are rapidly closing
- The number of hotel firms that failed in 2009 rose 61% compared with 2008
 - 122 hotels declared insolvent compared to 76 in previous year



Source: Wilkins Kennedy, accountancy firm

Reputational risk from Name Your Own Price

“Up to now, I was a very satisfied Priceline customer, and a regular user of the Hotel bidding service.

[...]

“This experience has really put me off Priceline. This is no way to run a business! Regardless of how they explain what happened, I will not recommend using their services again if they leave customers in the lurch like this. I am seriously considering taking legal action if this drags on any longer.”

- Dissatisfied priceline.com customer

Litigation is a legitimate cause of concern. Competitor Expedia settled numerous cases over similar lawsuits.

PCLN is an impending Short

1) Minimal barriers to entry = cut-throat competition

2) New industry entrants like Kayak.com

3) Strong performance belie severe headwinds

4) Low brand loyalty (VAR)

5) Name Your Own Price: a double-edged sword



Final Recommendation

MII initiate an initial short position of 0.75%, and scaling up the position as price moves downward

Target exit at \$240.00

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Prepared by Hideyuki Liu | 1 October 2010



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