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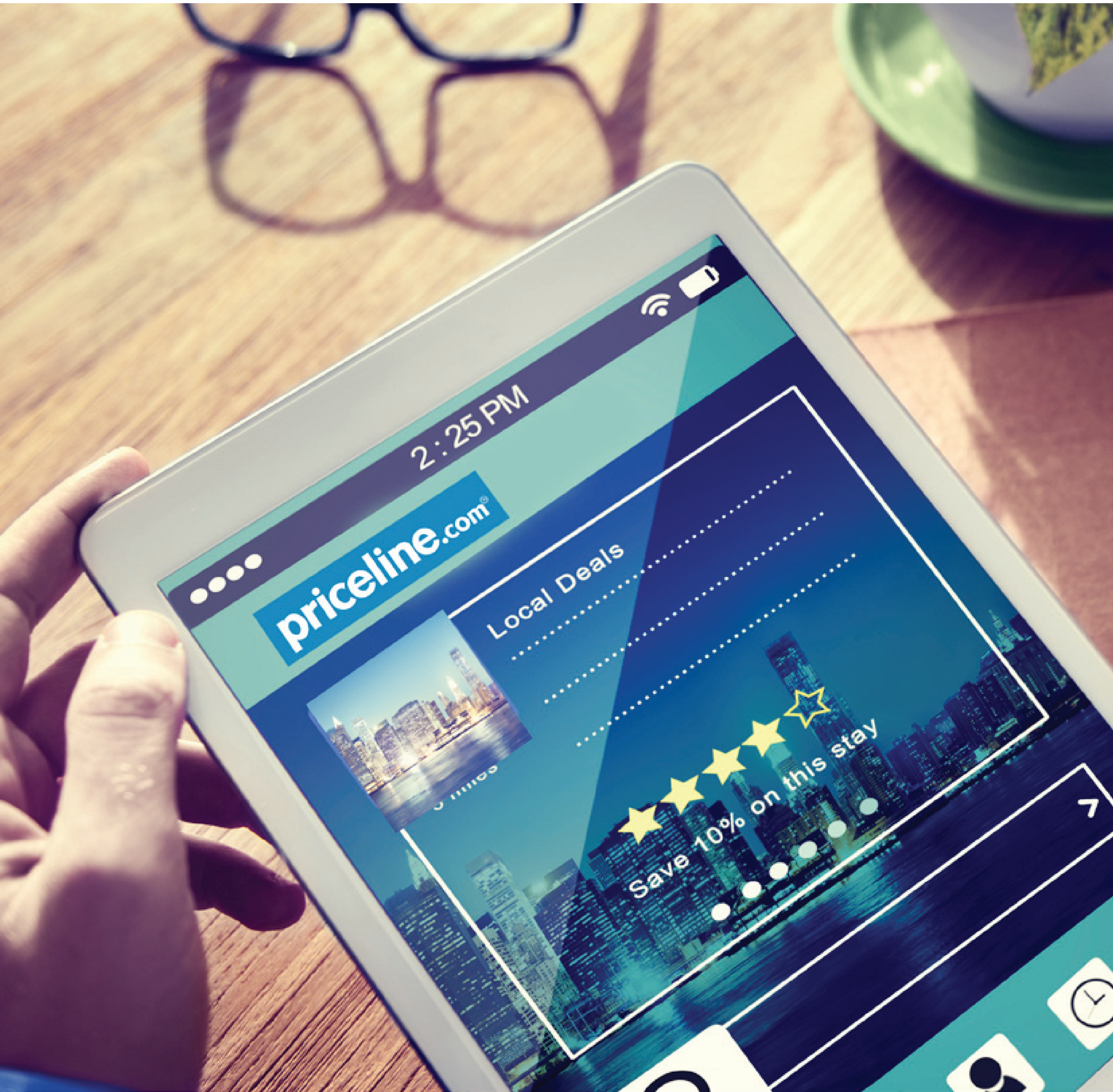
BUSINESS INTELLIGENCE

The Future of the Online Travel Giants: Priceline

Amy Scarth & Alex Hadwick



The Future of the Online Travel Giants: Priceline

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About EyeforTravel

We bring together everyone in the travel industry, from small tech start-ups to international hotel brands, to form a community working towards a smarter and more connected travel industry.

Our mission is to be the place our industry goes to share knowledge and data so that travel and tech brands can work collaboratively to create the perfect experience for the modern traveler.

We do this through our network of global events, our digital content, and our knowledge hub - EyeforTravel On Demand.

Our Values

We believe the industry must focus on a business and distribution model that always puts the customer at the center and produces great products. However, to deliver an outstanding travel experience, the strength, skills, and resources of all partners in the value chain must be respected and understood.

At EyeforTravel we believe the industry can achieve this goal by focusing on a business model that combines customer insight with great product and, most importantly, places the traveler experience at its core.

At our core, we aim to enable the above by valuing impartiality, independent thought, openness and cooperation. We hope that these qualities allow us to foster dialogue, guide business decisions, build partnerships and conduct thorough research directly with the industry.

These principles have guided us since 1997 and will continue to keep us at the forefront of the industry as a vibrant travel community for many more years to come.

Our Services

Our events are the heart of EyeforTravel. These draw in experts from every part of the travel industry to give thought provoking presentations and engage in discussions. It is our aim that every attendee takes back something new that can help their business to improve. This might be in the fields of consumer research, data insights, technological trends, or marketing and revenue management techniques.

Alongside this we provide our community with commentary, reports, white papers, webinars and other valuable expert-driven content. All of this can be accessed through one place - the On Demand subscription service.

We are always expanding the content we create, so please get in touch if you want to write an article for us, create a white paper or webinar, or feature in our podcast.

EyeforTravel in Numbers

70,000+ database contacts

2,500+ annual event attendees

100,000+ monthly online reach

1,000+ online conference presentations

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1.

Company Description and History

The Priceline Group was founded in 1997 and went public in 1999, raising a record USD12.9 billion in one day. Priceline operate a range of marketing websites that generate online travel bookings, predominantly linking consumers with suppliers. They make significant investments in consumer demand generation and sell accommodations, air tickets, car rental, cruise, packages etc, and more recently restaurant reservations since their acquisition of OpenTable.

Priceline currently operate six primary, independently managed brands:

- Booking.com
- Priceline.com
- KAYAK
- agoda.com
- rentalcars.com
- OpenTable

At the end of 2016 Priceline employed 18,500 employees (81% based outside the US) which is a significant growth from their 700 employees back in 2007. Priceline have also grown quickly from a small player a decade ago, generating around USD1 billion in revenue, to over USD10 billion in revenue in 2016. They now operate in 225 countries and territories. Their revenue, however, represents a fraction of the global travel industry so further growth potential for Priceline is very possible.

Priceline were originally known for their reverse auction model, called Name Your Own Price, an opaque transactional process they patented that allowed users to name their own price for hotel rooms and other travel services. On the other end, it enabled suppliers to sell excess inventory at a discount without affecting their retail price structures. This model was discontinued in September 2016 due to the growth in their retail business, competition, relative complexity, travel restrictions by service providers, difficulty of offering these services on mobile devices, increased discounts through closed user groups, and lack of discounted inventory from suppliers in periods of high consumer demand. Over the last couple of decades, Priceline has been evolving into an array of leading site for products and services of all sorts, and rapidly expanded with the acquisitions of sites such as Booking.com, KAYAK, and Momondo.

Today, their strategy involves maintaining multiple brands to capture growth in the online travel market, including mobile. They aim to achieve this through expanding their product/service offerings and penetrating new markets around the world, with China a particular focus for a number of minority investments. They largely invest resources into organically growing brands through advertising, targeting new markets or expanding the products they are able to offer consumers. In addition, they have and are expected to further invest in strategic transactions, such as acquisitions, joint ventures or other investments, in order to expand their businesses into complementary areas, expand their current business, acquire innovative technology and build their brand portfolio to keep up with the continuously changing travel distribution landscape.

2.

Financial Strength

Priceline make their money from a range of sources and models. Revenues and gross profit are derived from the following:

- Agency commission: earned from the sale of travel products and services.
- Merchant sales: transaction gross profit and customer processing fees from the sale of travel products.
- Advertising: primarily earned by their metasearch brand KAYAK, from sending referrals to online travel companies and travel suppliers, as well as display advertising on KAYAK websites and mobile apps.
- OpenTable: reservation revenues, subscription fees and other revenues from restaurants.
- Other fees: including excess waiver fees, travel insurance and GDS fees.

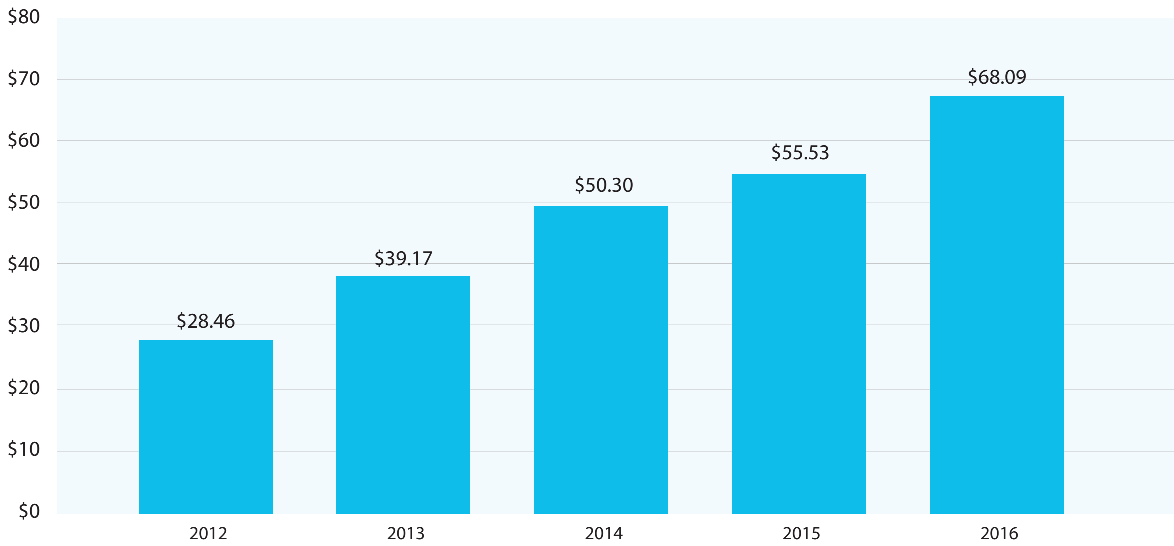
The Priceline business is primarily driven by international sales generated by Booking.com, agoda.com and RentalCars.com, as well as the international business from KAYAK, Momondo, and OpenTable. There are also minority stakes and distribution agreements with Ctrip and Meituan-Dianping. The significant majority of their gross profit comes from accommodation reservations. The majority of international bookings are generated through Booking.com and in 2016 the Booking.com brand represented approximately 88% of their gross profit.

In December 2016, the Priceline Group revenue hit USD10.7 billion, a 20% CAGR over the five-year review period from 2012. Most of this growth was organic rather than through acquiring brands. They are the largest OTA in the world in terms of revenue. Overall business for Priceline has generally been healthy and they have more than doubled their revenue over the last five years and their EBITDA growth even outpaces Amazon in percentage terms. Annual growth rates have slowed since 2013, a period in which they managed to boost their revenue by 38%. Although increases may be slower, they have reported continuous growth nonetheless.

2.1 What Is Company Turnover?

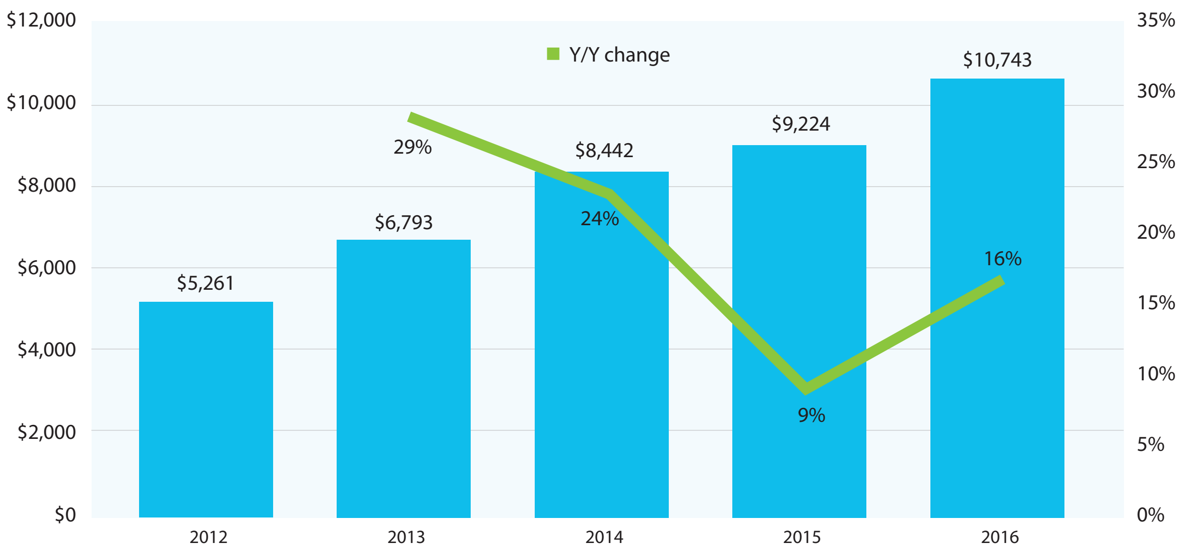
2015 was a relatively tough year for Priceline which is reflected in their reports; revenues increased by just 9% on 2014 results. However, after the set-back of this weaker year, in 2016 they reported stronger growth again, with gross revenue increasing by 16% and appear to have built on this on this in 2017, with total revenues growing 18% across the first three quarters of 2017. The 2015 decline in growth was partly driven by external factors such as terror attacks in Europe and the various health epidemics, as well as their efforts to expand into new markets across the world. The improvements in 2016 are thought partly to be a result of improved technologies and customer experience for Booking.com on both desktop and mobile and came in the face of a strong dollar depressing revenues from international markets. KAYAK also performed well in 2016 and expanded to Asia-Pacific and Latin America. Agoda, which is Singapore-based, also performed well despite some challenges in its markets, and rentalcars.com increased its mobile bookings and grew its supplier base.

Figure 1: Priceline Gross Bookings (USD billions)



Source: Priceline Group, 2017

Figure 2: Priceline Gross Revenue (USD millions)

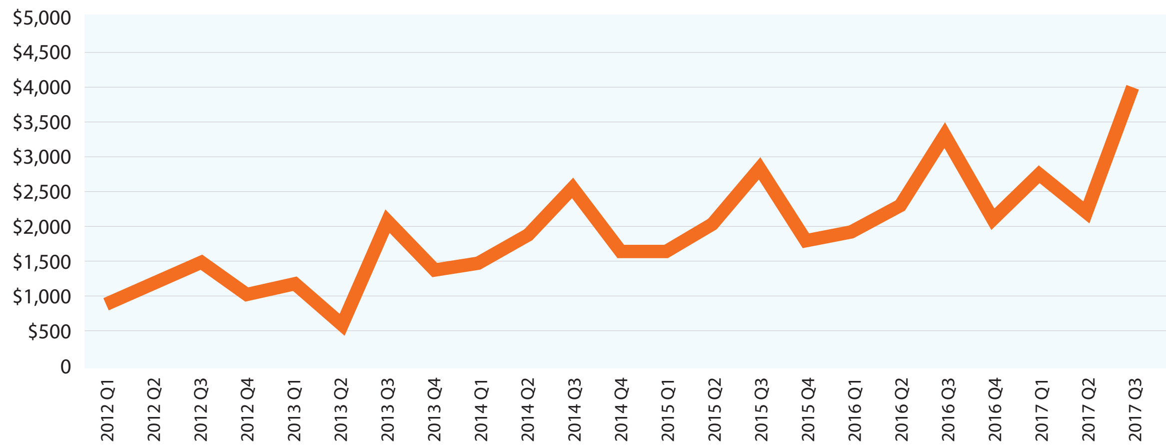


Source: Priceline Group, 2017

With sales growth having resumed, gross bookings reached a value of USD68 billion in 2016, achieving a 24.4% CAGR over the five years. They have multiplied the value of their gross bookings by 2.4 times from 2012. Gross bookings capture the total dollar value, include taxes and fees of bookings through their Online Travel Company (OTC) brands, net of cancellations. Their non-OTC brands, KAYAK and OpenTable, and the search queries through these channels, do not contribute to gross bookings, only revenue. The annual growth rates of actual bookings have been slightly stronger than associated revenues generated, but trends are generally similar. During 2016, gross bookings increased by 23% over 2015 results and 19.4% in the first three months of 2017.

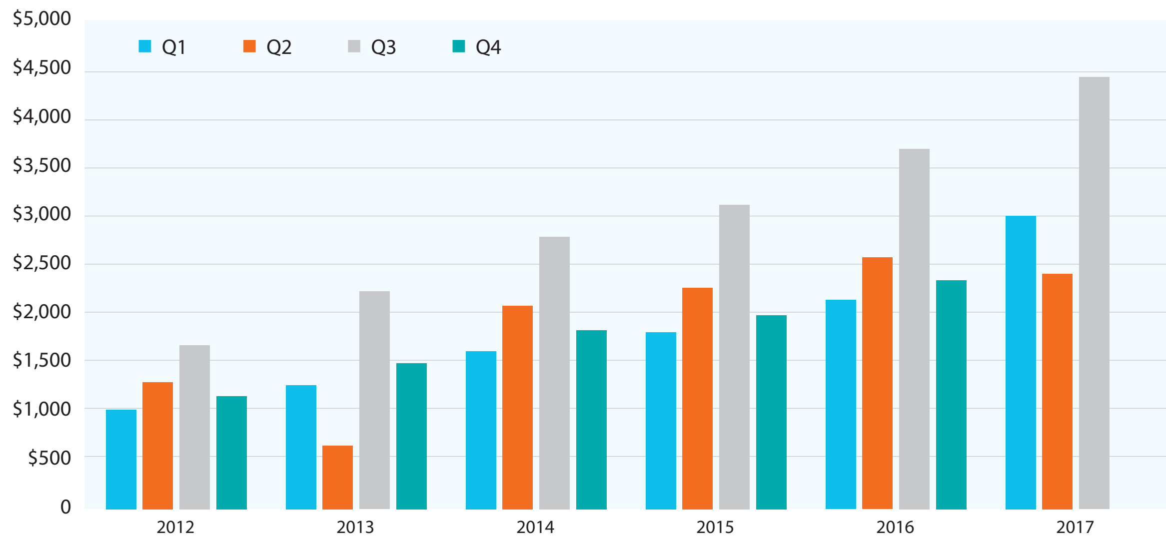
By reviewing results on a quarterly basis, we can identify some seasonality in Priceline's revenue. Q3 has been the most thriving financial period each year since 2012,

Figure 3: Gross Revenue by Quarter (USD Millions)



Source: Priceline Group, 2017

Figure 4: Gross Revenue by Quarter (USD Millions)



Source: Priceline Group, 2017

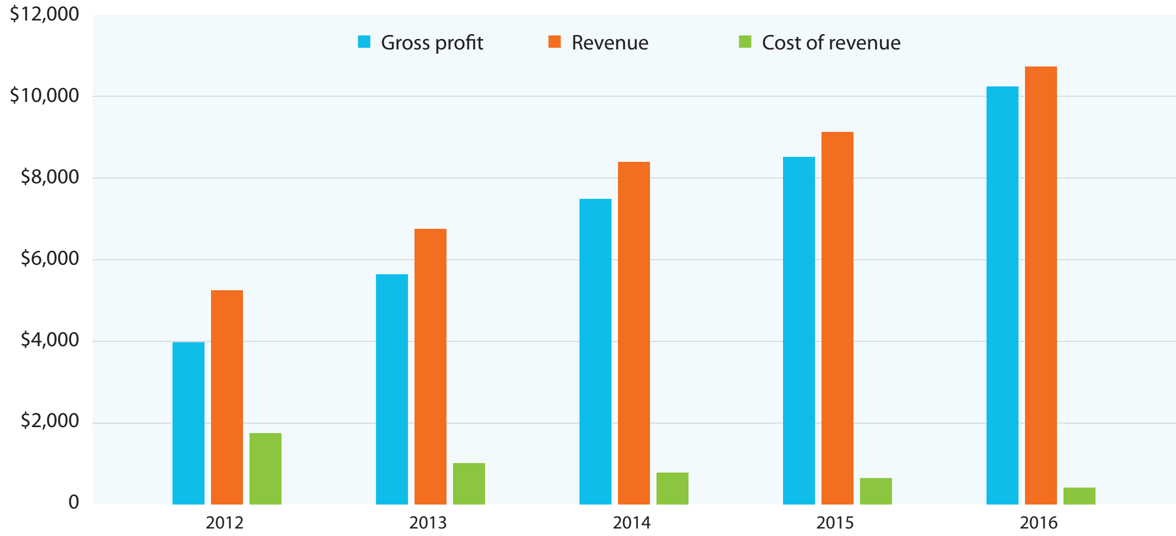
and increasingly so. Revenue peaked in Q3 2016 when Priceline generated USD3,691 million in gross revenues. It should be noted though that Priceline recognizes revenue from these bookings only when travel occurs, thus it is often in a quarter other than when it is booked and there is some lag in the reporting.

2.2 What Was the Profit Margin?

Priceline's gross profit is a healthy picture. Due to its scalable business model, much of the revenue increases they have achieved have been converted into profit. There is little or no cost associated with an increase in the bulk of their customers. Indeed, such is the increase in profits that Priceline's EBITDA from 2006 to 2016 has grown more in percentage terms than such lauded internet giants as Apple, Amazon, Alphabet (Google), and has trounced Expedia (The Economist, 2017).

The Priceline.com brand, predominantly based on the merchant model, is recorded on a 'gross' basis and has associated cost of revenue. All their other services are recorded in revenue on a 'net' basis and have no associated cost of revenue. The decline of merchant model revenues, which we discuss in more detail later on, is partly behind

Figure 5: Gross Profits and Revenues 2012 to 2016 (USD Millions)



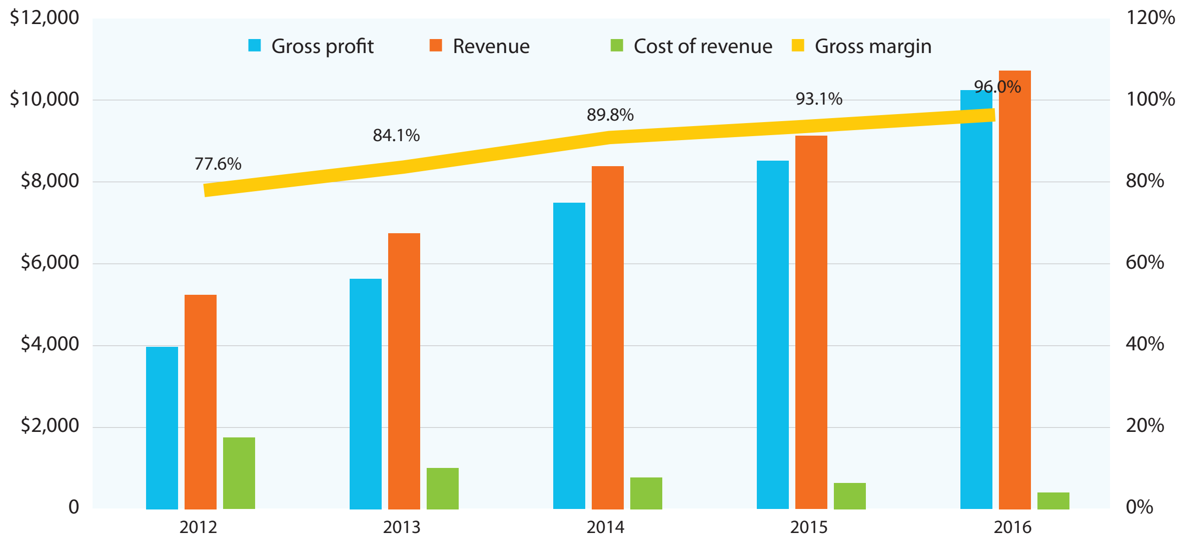
Source: Priceline Group, 2017

this trend. Cost of revenue has been reduced and margins have been increased. Their cost of revenue in 2016 was reduced to USD428.3 million, four times lower than that of 2012 and a negative 30% CAGR over the last five years. In 2016 costs were further cut, down by -32% and across the first quarters months of 2017 this section of Priceline's costs fell by a a further -39% YoY.

Gross profit includes agency, merchant and advertising/other profit. Gross profit for the group reached USD10.3 billion in 2016 and they have achieved a CAGR of 26% over the five-year review period. In 2016 gross profit increased by 20% on the previous year. Growth on a constant currency basis was approximately 23% if considering the strength of the US dollar impacting results.

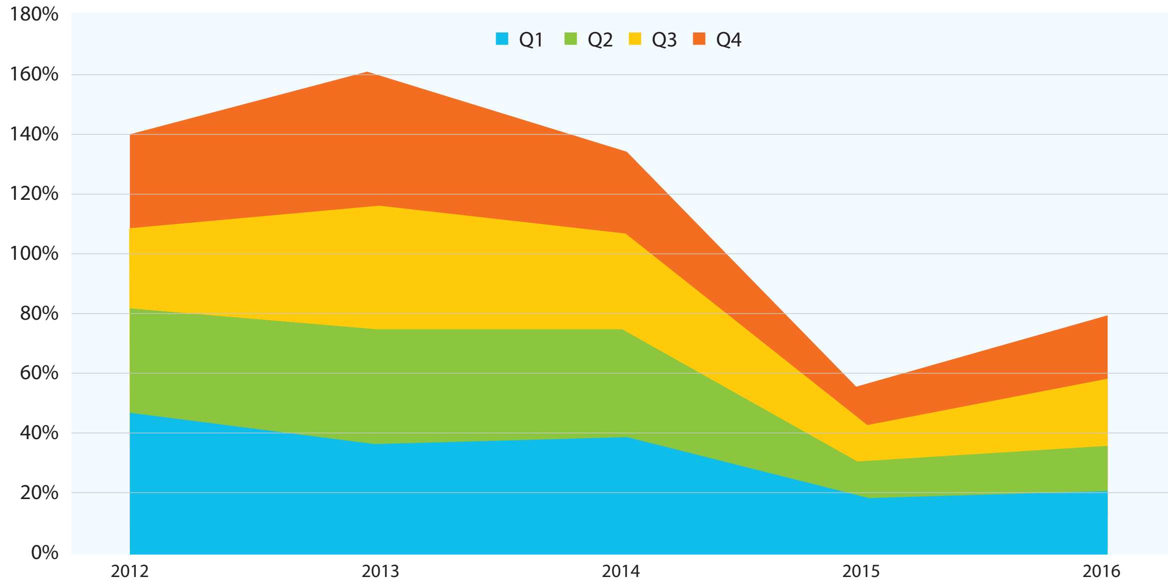
International operations accounted for approximately USD9.1 billion of Priceline's total gross profit in 2016

Figure 6: Gross Margin Percentage 2012 to 2016



Source: Priceline Group, 2017

Figure 7: Gross Profit Percentage Change YoY by Quarter



Source: Priceline Group, 2017

compared to USD7.4 billion in 2015, and an increase of 22.3%. Gross profit from US business increased 5.7% in 2016 owing to growth in gross profit of KAYAK and OpenTable, and partially offset by a decrease in gross profit for Priceline.com.

Agency gross profit represented the majority of total gross profit and included commissions, certain GDS booking fees and travel insurance fees. Merchant gross profit included profit from their transaction revenues from merchant retail, Express Deals sales and Name Your Own Price sales, ancillary fees, certain GDS fees and customer processing fees. Advertising and other revenues consisted primarily of KAYAK revenue from referrals, OpenTable, Priceline.com display advertising and Booking.com's BookingSuite analysis services.

Total gross margin is gross profit as a percentage of total revenue. In 2016 Priceline's gross margin was 96%, up 3% from 2015 or 16% higher than margins of 2012. In the last couple of years annual growth of gross profit has slowed, particularly in 2015, but there is not too much room left to grow for their gross margins! It is expected, however, that Priceline is in a good position to make higher revenue margins from its international business, because Europe and Asia-Pacific offer scope for premium pricing.

Gross profit as a percentage of gross bookings was 15.1% in 2016 compared to 15.5% in 2015. Priceline's opaque bookings model, 'Name Your Own Price' had even more premium pricing, leading to revenue margins in excess of 30% but that has now been discontinued.

As we have established, Priceline's business is predominantly generated from the hotel sector, and because hotel bookings offer online travel agencies higher revenue margins compared to other segments such as air ticket bookings and car rental sales, it helps them drive and sustain healthy margins. Priceline also currently has a significant share of the relatively less competitive and huge international hotel market, and it is this which should keep the margins of their hotel business at the higher end of the scale.

The Priceline revenue margins (revenue earned by the travel service provider as a percentage of the size of the booking) differ between sectors – hotel bookings stood at over 19%, air tickets at about 3% and car rentals at about 9% in 2016.

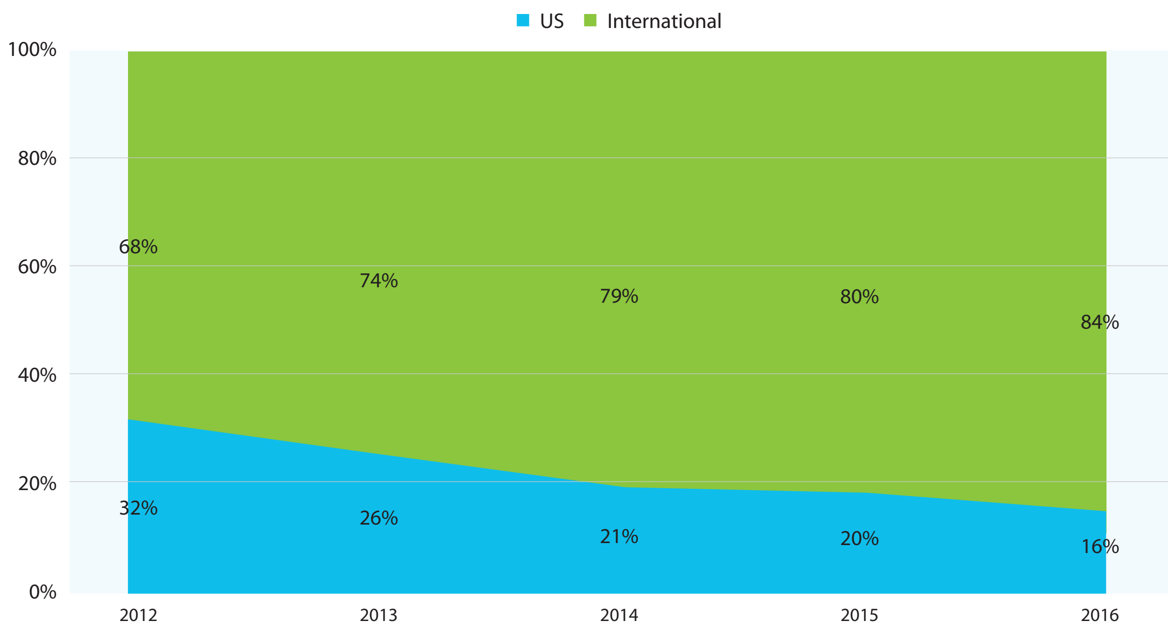
We recognize substantial seasonal trends in the quarterly data for gross profit; for example, in 2016 Q1, Q2, Q3 and Q4 recorded fluctuations in reported profit of 7%, 20%, 48% and -37% respectively. The reason late 2016 increased more than late 2015 was reportedly because their revenues were disproportionately affected by Priceline.com's Name Your Own Price reservation services, which are recorded as 'gross' with a corresponding cost of revenue, of which these represented a smaller percentage of total revenues in 2016 compared to 2015. Priceline suggest that seasonality can sometimes be exaggerated in the short term by their gross bookings growth rate, for example in periods when gross booking rates substantially decelerate, operating margins benefit from relatively less variable advertising expense. Gross profit growth is typically less impacted by decelerating gross bookings in the near term due to revenue related to reservations booked in previous quarters.

Priceline generates the majority of its business in markets outside the US, where they're headquartered. The company has built a deep global presence over its lifetime, strategically adding brands with international appeal and expanding their global footprint as a result. Priceline established its market share in Europe during the late 2000s and is now paying more attention to Asia and North America.

2.3 What Were the Different Revenue Streams and How Much Did They Make?

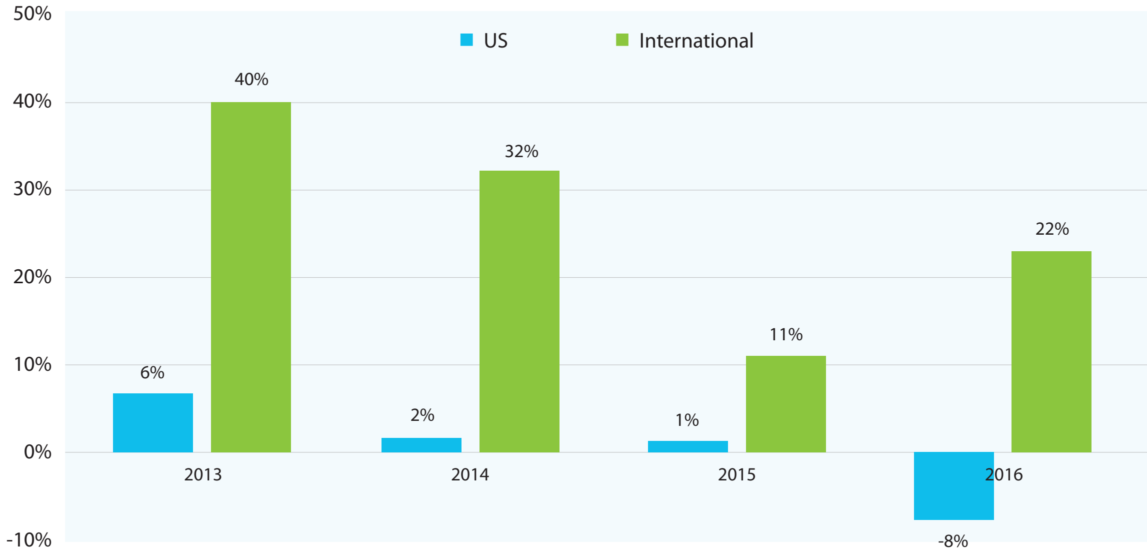
Priceline's biggest earner, Booking.com, is available in 43 languages so is well positioned to service international online travel markets. In 2016 international revenues increased to USD9,603 million and domestic (US) revenues dropped to USD1,680 million. The figures represent a 22% increase for international revenue from 2015 and a -8% reduction for US revenues. Throughout 2015 and 2016 the US dollar strengthened significantly and, because results are reported in US dollars, it is important to note that international figures will be impacted by a couple of percentage points. What is interesting is that 2016 was the first year in this review period that we have witnessed a decline. Growth in previous years for the US market has at times been more modest, between 1% and 6%, but this has slowed much further over the last few years to the point of decline in 2016. Priceline's Name Your Own Price business has been diminishing as consumers rejected the uncertainty of product quality so not meeting consumer demands stifled their US business somewhat. In terms of international revenues, growth has also slowed since 2012, a particularly strong year growing at a significant 40% on 2011. 2015 was the toughest year,

Figure 8: Percentage of Gross Revenues Derived from US and International Markets 2012 to 2016



Source: Priceline Group, 2017

Figure 9: YoY Percentage Change in Gross Revenues Derived from US and International Markets 2013 to 2016



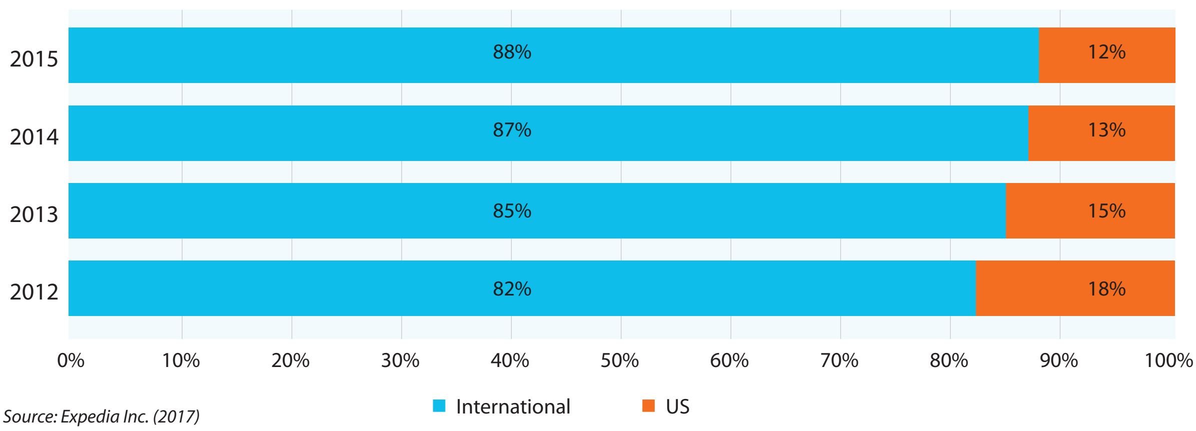
Source: Priceline Group, 2017

growing by just 11%, owing to terror attacks etc., but in 2016, Priceline picked up the pace once again, growing their international revenues by 22%.

It is clear that international markets are at the heart of Priceline's business success, and increasingly so. In 2012 international gross revenue accounted for 68% of total revenues and in 2016 this proportion increased to 84%. They operate not only in markets with high growth but also markets that combined are substantially greater in size than the US. Europe and Asia also have very different characteristics than the US; they are particularly fragmented compared to the US where the hotel market is dominated by large hotel chains, and that poses certain opportunities for Priceline. Priceline have designed reservations systems that are appealing to small chains and independent hotels and have become a very competitive and well-known distribution channel for accommodation suppliers in these regions.

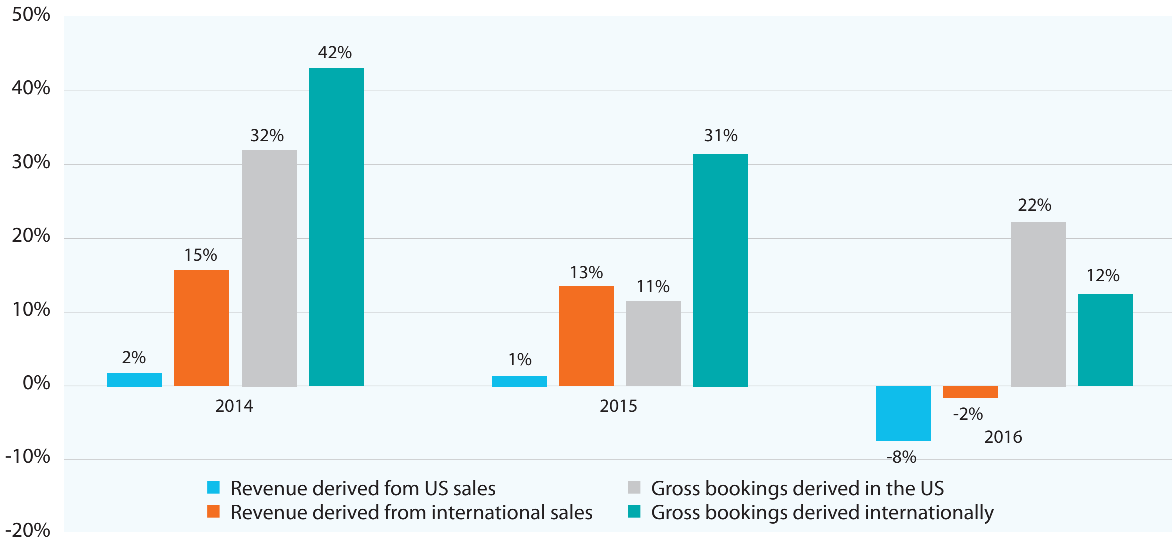
The proportion of gross bookings by international markets has historically been much higher than gross revenues, possibly indicating greater margins in the US market. The change in the proportion of gross bookings from domestic versus international markets

Figure 10: Share of Gross Bookings by Source Market from 2012 to 2015



Source: Expedia Inc. (2017)

Figure 11: YoY Percentage Change in Revenues and Gross Bookings Derived from US and International Sales 2014 to 2016



Source: Priceline Group, 2017

has been less significant, because in 2016 international markets contributed 88% of gross bookings, up from 82% in 2012. Therefore, based on the situation that international markets are contributing relatively similar proportions of gross bookings during the review period, but a greater proportion of gross revenues, it would suggest either margins in the US are tightening or margins in the international markets are increasing.

Considering year-on-year growth patterns over the last three years, we can identify a real shift in the source markets for Priceline bookings and revenues, particularly in 2016 when both bookings and revenues from the US market declined, by -2% and -8% respectively. Despite modest growth earlier in the review period, in 2014 and 2015 both bookings and revenue in the US market increased. In 2015, for example, bookings grew by 13% and revenue by 1%, but 2016 really indicates a weakening domestic market. International bookings and revenue on the other hand have continued to increase, at 12% and 22% in 2015 and 2016 respectively.

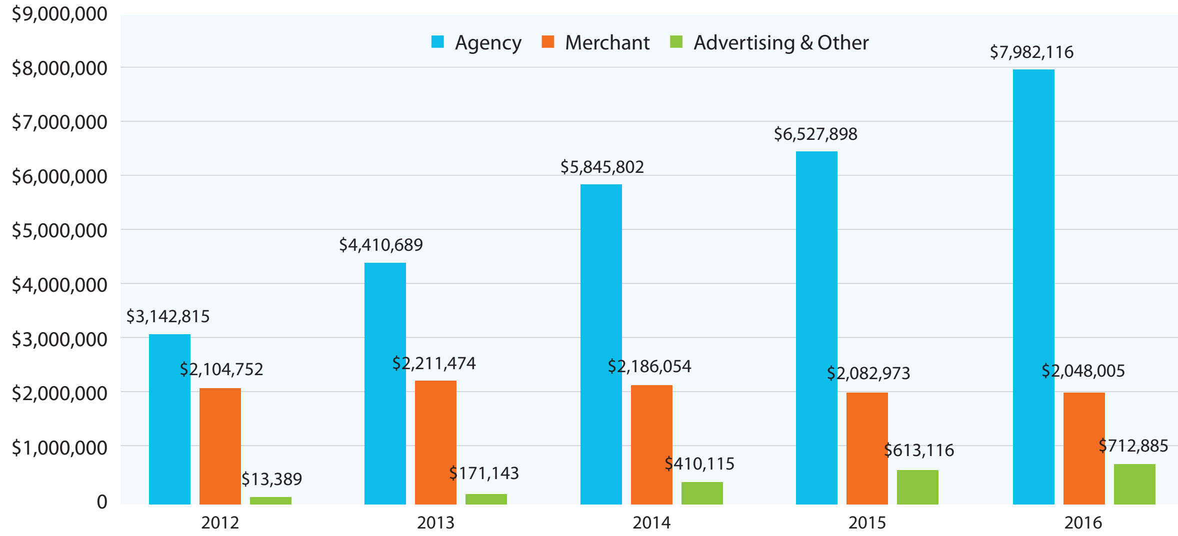
2.3.1 Agency Versus Merchant

In 2016 agency revenues reached USD7,982 million, up by 22% from 2015, and a 26% CAGR during the 2012-2016 review period. The growth was primarily due to Booking.com. The agency model accounts for the vast majority of Priceline's revenue, a fruitful lower risk approach in that they generate revenue from transactions without being the merchant. Rather, they connect the travel consumer with the travel supplier, and collect a commission when the booking is made. Priceline's goal in the context of its agency model is to maintain and grow the volume of transactions, thus drive revenue from associated commissions. This model gives them less control around pricing compared to the merchant model, but delivers higher profit margins as it has almost no associated cost of inventory on sales.

Merchant revenues are Priceline's second largest segment; however, this model has not actually contributed to the recent growth of the company, with a -0.7% CAGR between 2012 and 2016. In 2016 the merchant model generated USD2,048 million in gross revenue, a significantly smaller value than agency transactions. Merchant bookings include merchant accommodation reservations of Booking.com and Agoda.com, revenue from rentalcars.com, and merchant airline ticket sales from Priceline.com.

Their declining proportion of total sales is not because of its less favorable cost of revenue, but is driven mainly by the supply side according to Priceline, who do not have as much perishing inventory as previous years,

Figure 12: Revenue by Model 2012 to 2016 (USD Thousands)



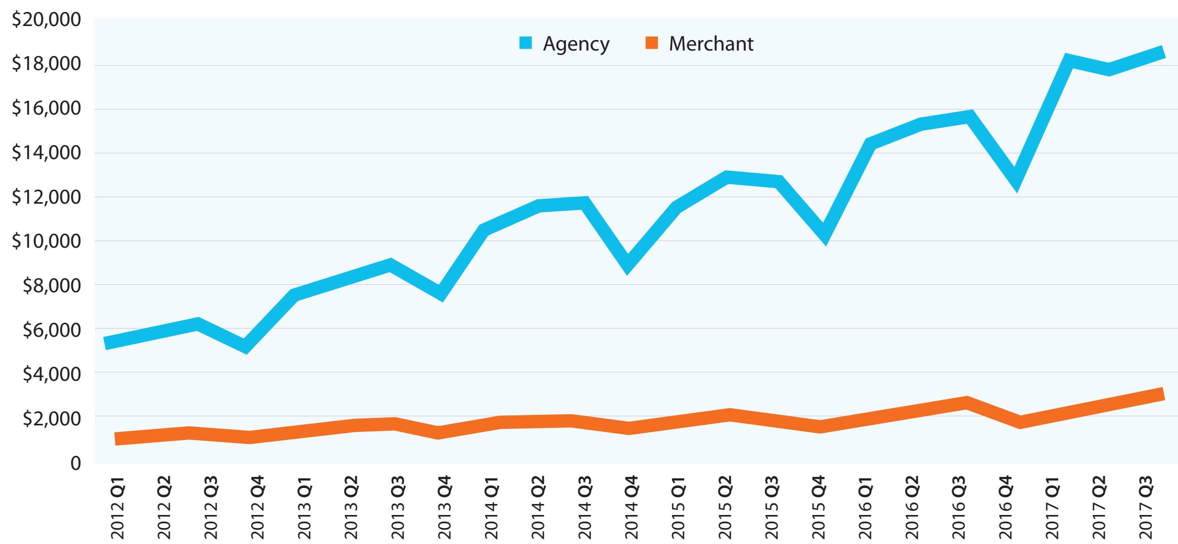
Source: Priceline Group, 2017

and because suppliers have raised their efforts in direct distribution with their own deals. The opaque travel industry (such as their Name Our Own Price) is fading and with that, their merchant revenues follow that trend.

In their goal to increase the volume and variety of accommodations available on Booking.com, according to Priceline they are, however, increasingly processing transactions on a merchant basis, facilitating payments on behalf of customers, especially for those not accepting credit cards, as well as creating more flexibility for consumers in terms of the form and timing of payment. It remains to be seen if this shifts the balance in the next few years.

Seasonality patterns for merchant and agency gross bookings differ. Agency bookings are more seasonal and Q2 and Q3 generate the annual peaks. For example, in 2016 Q1, Q2, Q3 and Q4 accounted for USD14.5 billion,

Figure 13: Quarterly Gross Bookings – Agency Versus Merchant



Source: Priceline Group, 2017

USD15.4 billion, USD15.8 billion and USD13 billion, respectively. The seasonal trend within the merchant model is more flat. However, they do also peak in Q2 and Q3. In 2016 gross bookings under the merchant model generated USD2.1 billion, USD2.5 billion, USD2.7 billion and USD2.1 billion for Q1, Q2, Q3 and Q4 respectively.

2.3.2 Revenue by Vertical and Season

Advertising revenue has been Priceline's largest and newest growth area, resulting in a 170% CAGR over the period 2012 to 2016. This is a particularly high rate because growth is initially expected when they only recently began to push this revenue stream in relation to others. Targeted advertising as a revenue stream has generally grown to become more important for OTAs in recent years as they capitalize on their huge volumes of online consumer traffic. Priceline generated USD713 million in gross revenue from their advertising revenue streams during 2016. Growth is primarily generated from their KAYAK metasearch platform, OpenTable reservation and subscription fees, and advertising revenue from Priceline.com. KAYAK has experienced healthy growth and is currently expanding into key regions such as Asia and Latin America and Momondo has added a strong European brand into the advertising revenue mix. Growth rates for advertising revenue are expected to slow over the next few years, but continue.

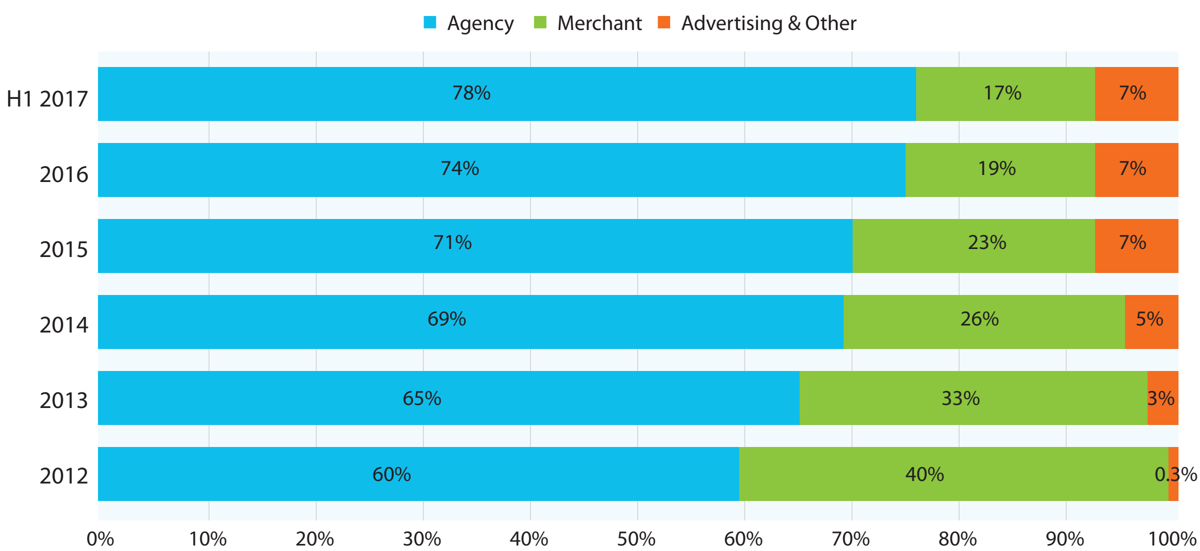
In 2016 agency revenue grew to 74% of Priceline's total gross revenue, up from a 60% proportion in 2012. The agency model has eroded the significance of the merchant model which now accounts only for 19% of total gross revenue, a big change from the 40% back in 2012. We can see that advertising revenues are have become a key part of the revenue mix, growing to 7% of total revenue in 2016 but strong growth in the core agency accommodation bookings means that advertising revenues decreased to 6% of the revenue mix across the first three quarters of 2017. The real growth of this revenue stream began in 2013.

According to Priceline, Q1 is typically their lowest level of profitability due to seasonal timings. In Asia-Pacific business they experience the highest levels of accommodation bookings in Q3 and Q4, and the highest levels of travel consumption in Q4. In Europe and North America the highest levels of accommodation checkouts are in Q2 and Q3, thus where their highest levels of profitability are right now.

2.4 How Many Room Nights and Flights Were Sold?

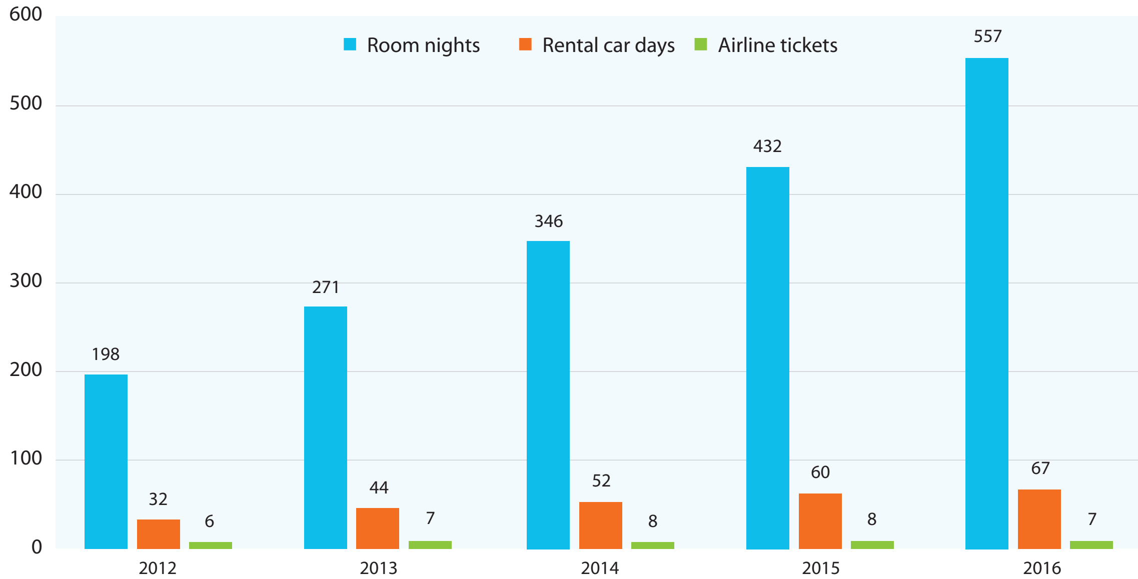
By taking a look at the different travel product volumes distributed via the Priceline websites and considering room nights, car rental and air tickets

Figure 14: Revenue Generated by Model as a Percentage of Gross Revenue 2012 to 2016



Source: Priceline Group, 2017

Figure 15: Products Sold by Millions of Bookings made 2012 to 2016



Source: Priceline Group, 2017

sold, as this is all they publicly report, it is very clear that accommodation is Priceline's key product and where the growth is. In 2016 they sold 557 million room nights, up 29% from 2015 and a 30% CAGR over the five-year review period. Rental car days have performed well, rising at a 20% CAGR between 2012 and 2016, but this is based on far lower volumes. In 2016 they sold 67 million rental car days. This is higher than airline tickets which is a comparatively insignificant proportion of their overall business, and growth has been relatively static over this review period, a 2012-2016 CAGR of 3%. Priceline sold 7 million airline tickets in 2016, down from 8 million in 2015.

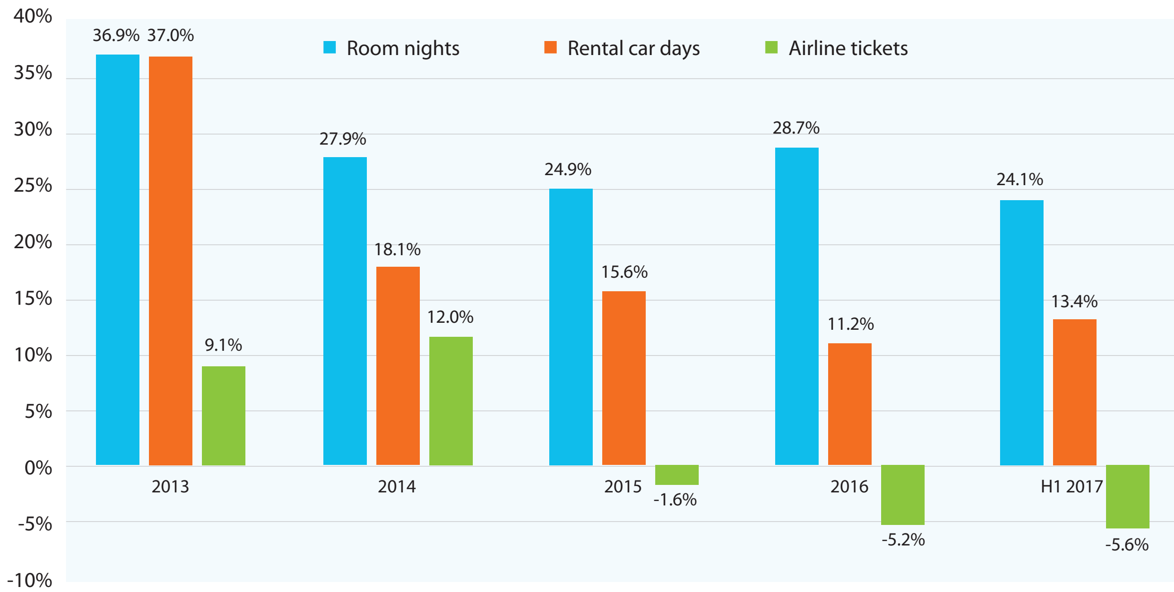
In terms of products, as we have established above, the hotel business remains the fastest growing segment for Priceline and makes up the majority of their revenue and profit, driven by the fact that hotel bookings have higher margins compared to other products. In 2013 annual growth rates for room nights and rental car days were on a par at 37%, but since then, the volume of room nights sold has grown at a faster rate – last year by 29% for room nights, compared to 11% for rental car days. Priceline expect their room night growth to decelerate further.

Car rental has a higher margin than airline tickets, but is much lower than hotel bookings. Car rentals are particularly useful in their consumer offering of packages, which overall have better margins.

Airline ticket sales have been lagging behind throughout the entire review period and in the last two years they reported negative growth rates of -1.6% and -5.2% in 2015 and 2016 respectively. This is due to a decline in Priceline.com's retail airline ticket reservations and the discontinuation of Name Your Own Price in September 2016, partially offset by an increase in Priceline.com's Express Deals airline ticket reservations. Airline bookings are increasingly common on metasearch sites such as Priceline.com and KAYAK, but still make up a small part of their overall business. Margins on these transactions are also very low.

Some of the success of Booking.com has come from its wide range of accommodation products, not charging a booking fee and being able to instantly confirm reservations. They intend to increase their supply base in order to expand consumer choice further. Booking.com is currently becoming more aggressive in penetrating the single-owner, single-room market – a

Figure 16: YoY Percentage Change in Products Sold 2013 to 2016



Source: Priceline Group, 2017

growing segment of the industry, referred to as vacation rentals or alternative accommodations. They do not currently split the growth rate of hotels and vacation rentals, but suggest vacation rentals are contributing to their room night growth quite substantially, and expect this will grow.

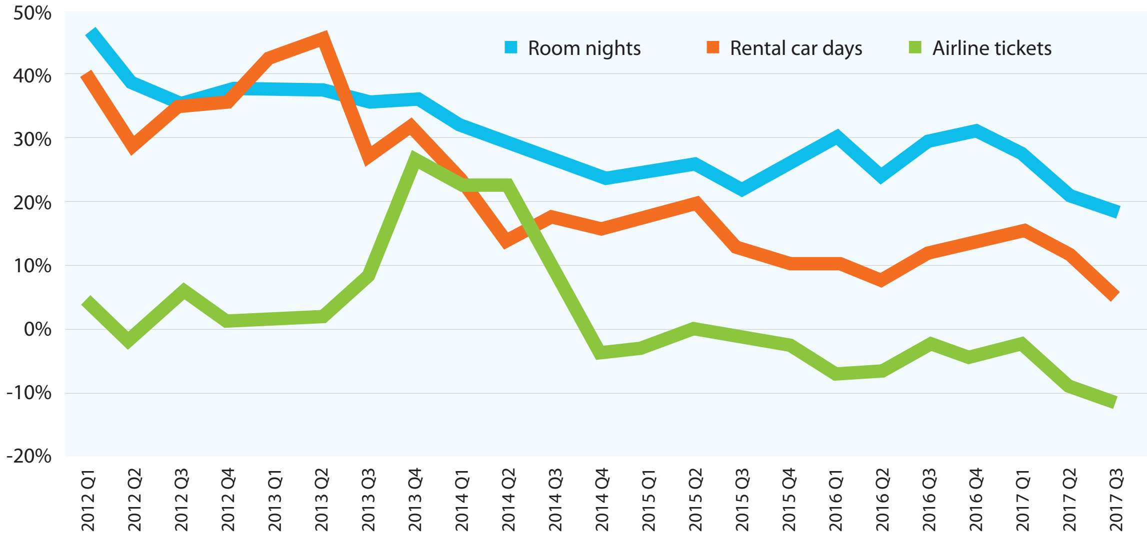
Priceline suggest the growth in their hotel business is partly a result of:

- Growth in the online travel market.
- Emerging market travel growth (focused on APAC and South America).
- Increasing mobile device use for travel research and booking.
- Building accommodations supply globally.
- Effective content and distribution.
- Consumer experience improvements on their website and mobile apps.

Booking.com generated the majority of the company's room night growth and by the end of 2016 they listed over 1,115,000 properties on their website, including 568,000 vacation rental properties. This has increased from a total of 852,000 properties in 2015, equivalent to an increase of 31% YoY. Vacation rental properties rose 46% in 2016. They have followed this up by continuing the drive to increase the number of available properties to 1,534,000 at the time of writing (November 2017), equivalent to a further increase of 38%. This includes more just over 860,000 vacation rentals, representing a notable slowdown in growth on this front to a crawl. According to Priceline, their growth in the vacation rental sector had been helped by not charging a booking fee like their competitors Airbnb and HomeAway. The recent slowdown may be indicative of over exposure in the sector as a whole as reports from UBS and Morgan Stanley have also suggested that Airbnb's growth has also slowed down recently (CNBC, 2017; FT, 2017a).

Priceline's vacation rental properties generally consist of single-unit and multi-unit villas, apartments, 'aparthotels' (which have a front desk and cleaning service) and chalets, they are generally self-catered and directly bookable. As they represent an increasing proportion of total properties added to their websites, they expect their gross bookings growth rate and property growth rate to diverge over time as this segment offers fewer booking opportunities, thus this may negatively affect their profits margins owing to different characteristics from hotels.

Figure 17: YoY Percentage Change in Products Sold by Quarter from 2012 to Q3 2017



Source: Priceline Group, 2017

The below chart illustrates the change in volumes of sales by product in each quarter for the last five years. Room nights and rental car days have followed a similar pattern, but car rental appears more erratic quarter to quarter. Airline ticket sales growth were looking relatively good in 2014, but are now in negative growth.

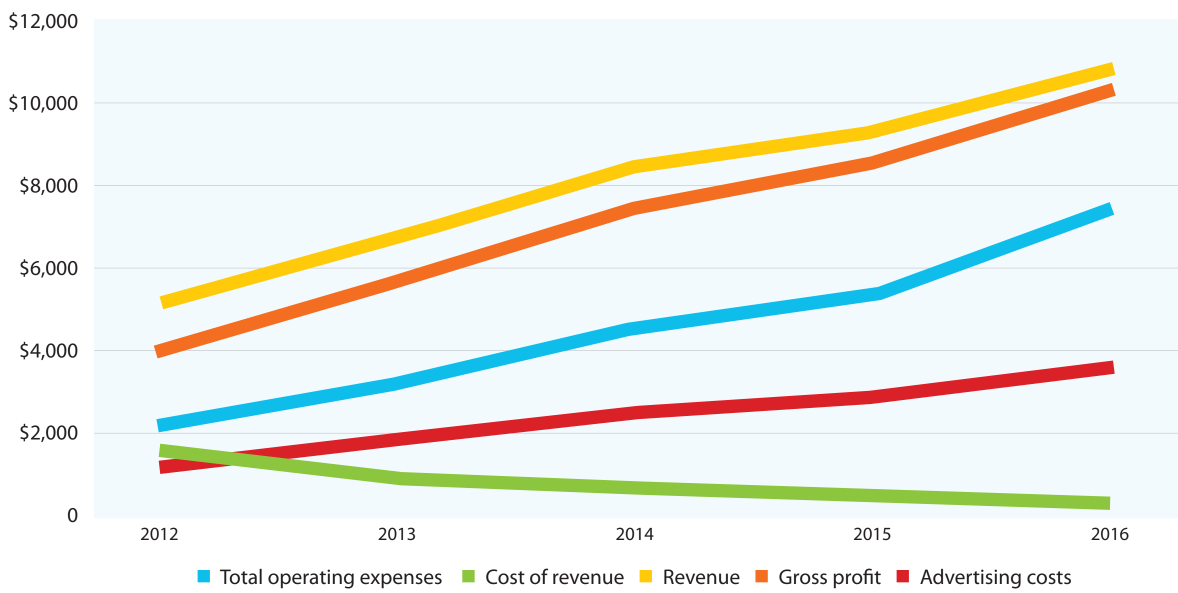
3.

Costs and Debts

Priceline need to maintain their expenses to fend off the competition and, whilst the mix of expenses may well change, the way Priceline split their budgets has remained relatively static recently. During our review period Priceline have slightly changed their reported expenditure categories for advertising. In 2012 and 2013 they reported online and offline advertising, but in 2016 adjusted their 2014 onwards advertising to performance and brand advertising. Figure 18 shows revenues, gross profits, and costs as reported by Priceline. Priceline has been able to push down its cost of revenues, leaving Priceline with a self-reported gross margin of 97.6%. However, this doesn't tell the whole story, with the cost of advertising continuing to rise across the period, with a CAGR of 23.6%. Combined with other costs, such as personnel, sales and IT costs, the total operating expenses have drifted upwards, causing concern among investors and undercutting the headline stellar performance of Priceline's EBITDA, with stocks taking a beating after Q2 and Q3 results in 2007, even though earnings growth was strong in both (see Chapter 6 for more).

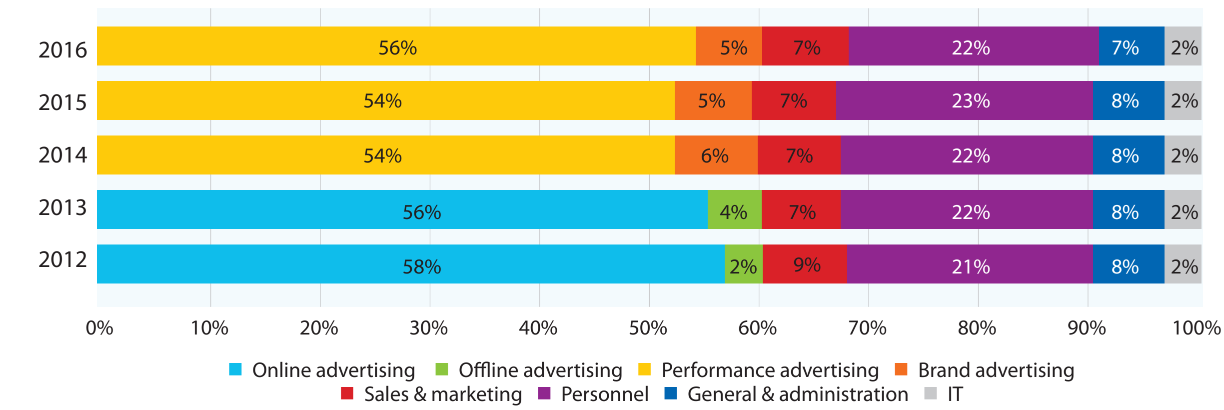
In terms of overall expenditures we can see that advertising makes up the majority of Priceline's expenditure, a total of 61% in 2016, rising to 63% in 2017. If the sales and marketing costs category is included, then this rises to 70% of costs. The majority of their advertising spend is online or performance based, 56% of all costs in 2016 and 58% in H1 2017. Personnel

Figure 18: Expenses Versus Revenues 2012 to 2016 (USD millions)



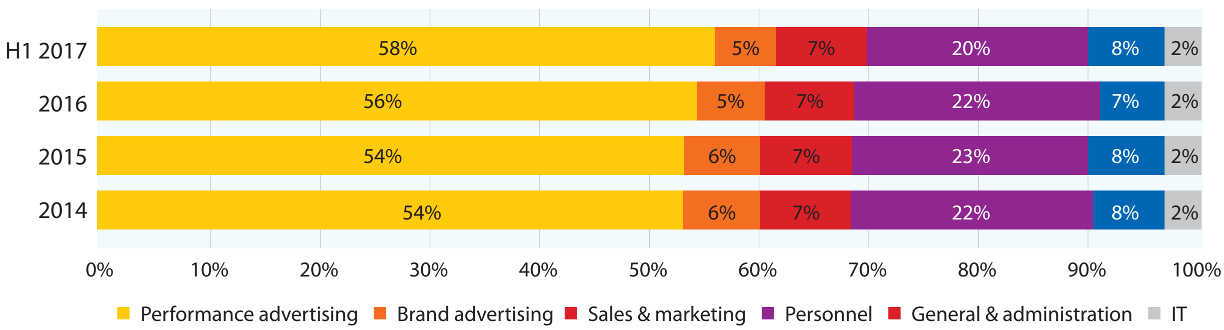
Source: Priceline Group, 2017

Figure 19: Priceline Costs by Company-Defined Categories 2012 to 2016



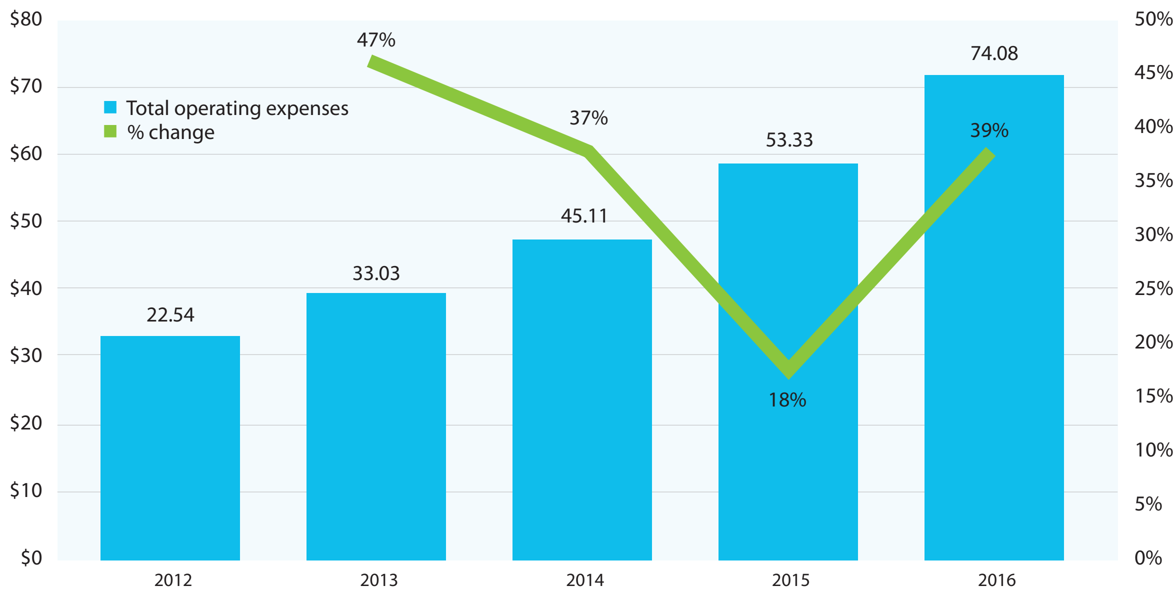
Source: Priceline Group, 2017

Figure 20: Priceline Costs by Company-Defined Categories 2014 to H1 2017



Source: Priceline Group, 2017

Figure 21: Priceline Operating Expenses and YoY Percentage Change (USD Millions)



Source: Priceline Group, 2017

make up the next biggest cost taking 20% of these total budgets, followed by sales and marketing at 8%, general and administration at 7%, and IT using 2% (see Figure 20).

With growth in the overall business comes an increase in operating expenses. In 2016 Priceline's operating expenses reached USD74 million, an increase of 39% from 2015 and a 35% CAGR during 2012-2016. These growth rates are over and above the growth in gross bookings and revenue, at 24% and 20% respectively. 2013 saw a big shift in operating expenses, increasing by a significant 47%.

However, with cost of revenues under control, and gross revenue going up, margins as we looked at above are healthy. Cost of revenues consisted primarily of:

- The cost paid to travel suppliers for Priceline.com's Name Your Own Price and package services, net of taxes and charges
- Fees to third parties by KAYAK and Priceline.com

The decrease in cost of revenues is partly due to the decrease in Priceline.com's Name Your Own Price services, as well as a positive impact by a reduction in travel transaction taxes of USD5.1 million in Q3 2016 related to a cash refund from the State of Hawaii.

3.1 How Much Is the Priceline Group Spending on Marketing?

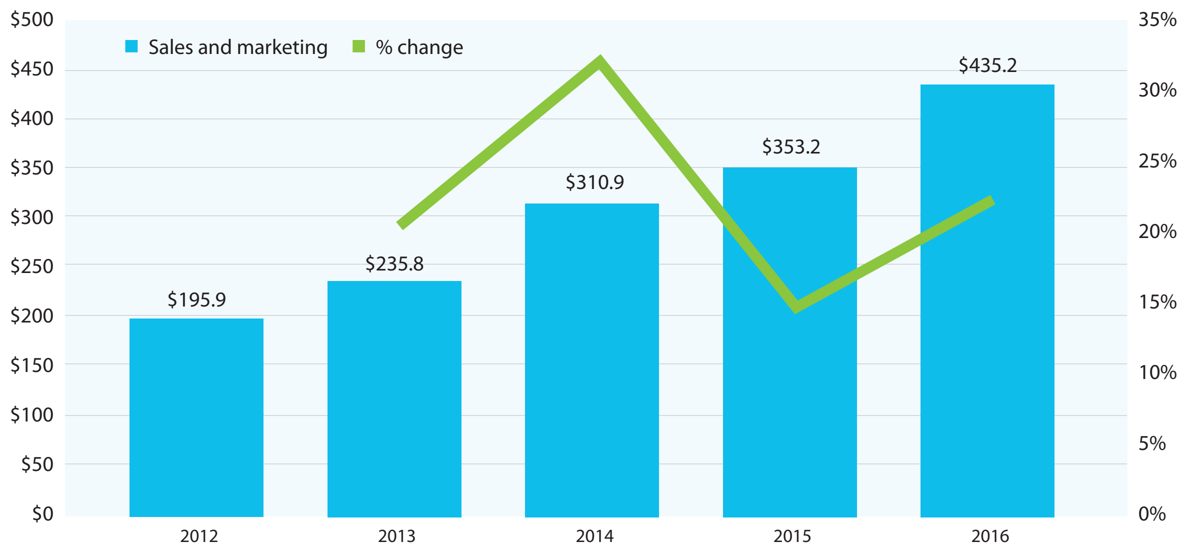
Sales and marketing, which does not include their advertising costs, increased to USD435 million in 2016, up from USD353 million in 2015, and had a 2012-2016 CAGR of 22%, reflecting the growth patterns in both revenue and bookings. Sales and marketing expenses consist primarily of:

- Merchant transaction credit card and other payment processing fees.
- Third party call centers, website content translation fees, etc.
- Customer relations.
- Merchant transaction customer chargebacks.
- Bad debt usually related to agency accommodation commission receivables.
- Promotional and trade shows.

According to the Priceline 2016 annual report, the increase in sales and marketing spend is due to increased transaction volumes and a higher provision for customer chargebacks associated with merchant transactions. Information Technology (IT) expenses have increased because of their growth in worldwide operations.

Advertising, both online and offline, increased at a 30%

Figure 22: Sales and Marketing Spend 2012 to 2016 (USD Millions)



Source: Priceline Group, 2017

CAGR during 2012-2016 and they spent USD3.8 billion on advertising in 2016, a three-fold rise from 2012 which was a much smaller USD1.3 billion budget. This slowed slightly in the first three quarters of 2017 but was still a substantial 22% YoY rise.

From 2012 to 2015 Priceline divided their advertising spend by online and offline. Online advertising has been a key driver of the Priceline business, but offline has marginally increased in significance in terms of the overall budget. In 2012 online advertising accounted for 97% of all advertising spend, but during 2013, 2014 and 2015 offline advertising grew to 7%, 9% and 7% of total advertising spend in those respective years. This continued to be relatively stable, remaining at 9% through the first three quarters of 2017.

Performance advertising includes:

- Search engine keyword purchases.
- Referrals from metasearch and travel research websites.
- Affiliate programs.
- Other performance-based advertisements.

Performance advertising as a percentage of gross profit increased in 2016 due to paid traffic channels and a year-over-year decline in advertising ROIs and has increased again across the first three quarters of 2017 from 34.1% of gross profit in 2016 to 34.7% in 2017.

Brand advertising is predominantly related to Booking.com, KAYAK, Priceline.com and agoda.com and includes:

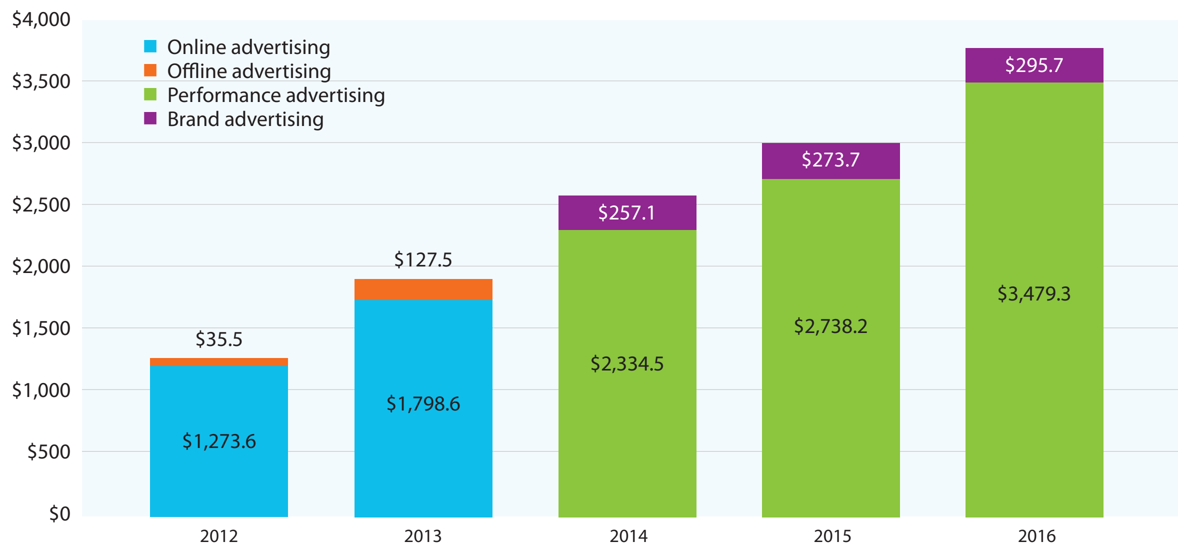
- TV advertising.
- Online video advertising.
- Online display advertising.

Priceline intends to continue to promote brand awareness through online and offline advertising, including executing various brand campaigns as they expand into new markets around the world. It is fundamental for Priceline to acquire and retain customers through maintaining and strengthening their brands.

According to Priceline, in 2016 their performance advertising efficiency declined over 2015 due to growth in paid traffic channels, lower ROIs and timing and booking versus travel.

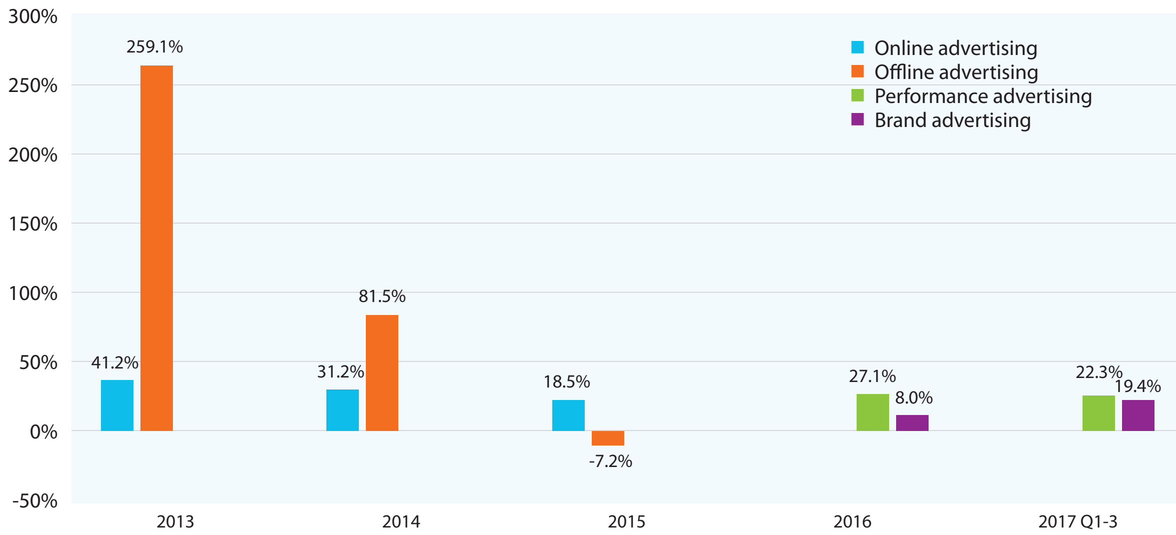
To generate traffic to their websites they mainly use third-party websites including online search engines (primarily Google), metasearch and travel research

Figure 23: Advertising Spend by Self-Reported Categories 2012 to 2016 (USD Millions)



Source: Priceline Group, 2017

Figure 24: Percentage Change in Advertising Spend in Self-Reported Categories 2013 to Q1 to Q3 2017



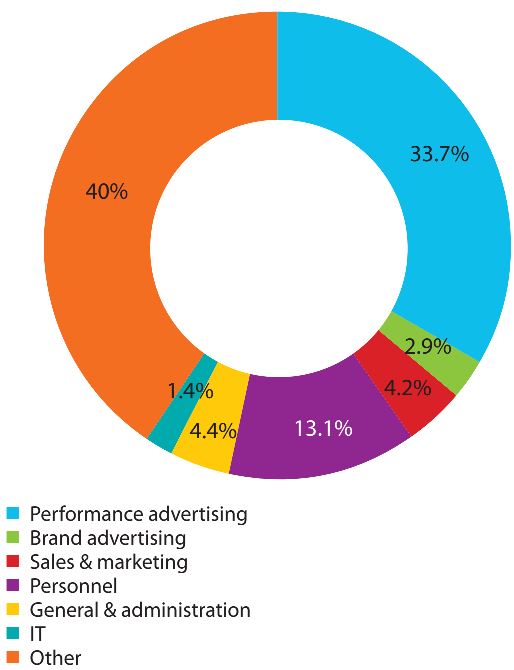
Source: Priceline Group, 2017

services, as well as affiliate marketing. Pay-per-click advertising is core to their strategy. They bid on hundreds of millions of multilingual keywords across desktop and mobile to raise their share of demand channels. Priceline have continuously fine-tuned their sites so that when they attract the consumer through advertising expenditure, they raise conversions and turn buyers into long-term loyal customers. Mobile is increasingly important for Priceline and their competitors, and they have experienced a significant shift of business to mobile platforms. Performance advertising sits across both web and mobile channels.

In terms of value, Priceline spent USD296 million on brand advertising in 2016, and USD3,479 million on performance advertising.

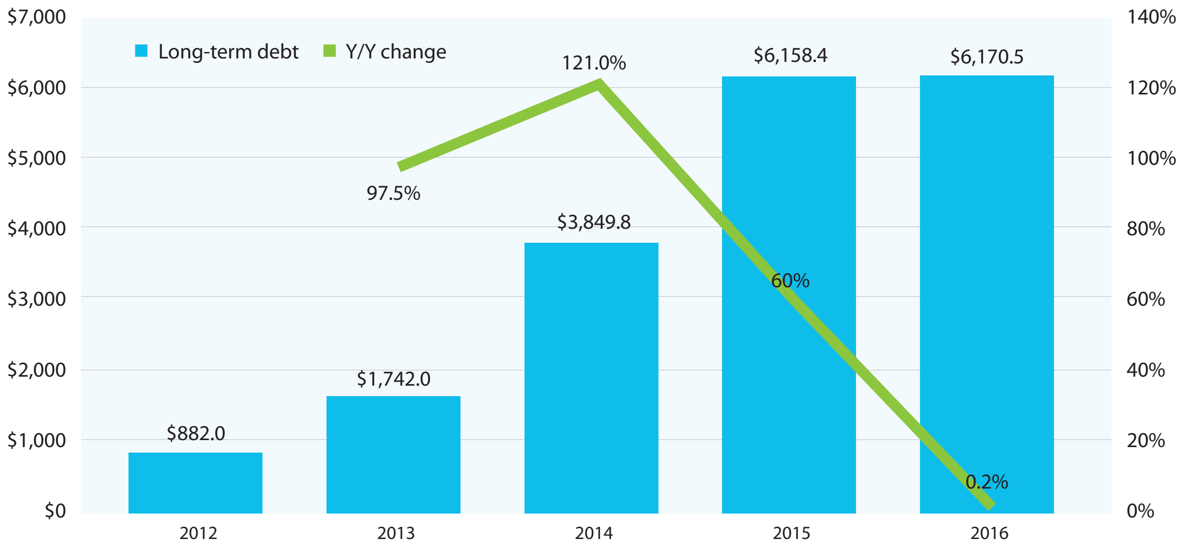
In 2016 the increase in brand advertising was due to investments in online video and TV advertising for Booking.com; figures include production costs. KAYAK and Priceline.com were allocated lower TV advertising budgets in 2016 which slightly offset the above increase. Booking.com has been increasingly using TV advertising and targeting consumers at the mid to higher end of the travel funnel, whereas historically they tended to focus very low in the funnel, where consumers have a very clear intent. Over the last decade this low-end funnel strategy has driven their business, but in 2013 they started offline advertising in the US and are eyeing up more investments in this area to boost Booking.com's presence as a household brand in travel. They have also recently invested in TV

Figure 25: 2016 Costs as a Percentage of Gross Profit



Source: Priceline Group, 2017

Figure 26: Priceline Total Debt Holdings 2012 to 2016 (USD Millions)



Source: Priceline Group, 2017

advertising for Europe as well, hoping to create greater awareness up in the funnel, and then, as a result, improve their performance marketing at the low end of the funnel.

Whilst brand and offline advertising is increasing in comparison to the historically more pure online focus, performance advertising is at their core and in 2016 they raised the budgets by 27%, compared to an 8% increase for brand advertising. Across the first three quarters of 2017, overall combined advertising costs from both categories rose by 22%, with performance increasing 22.3% and brand increasing 20.4%.

In 2016 performance advertising accounted for 34% of gross profit, compared to 2.9% of brand advertising. Personnel made up 13% of gross profit.

3.2 Debts

Priceline have been focusing on organic growth in the last year. Their debt did not change significantly between 2015 and 2016. In 2016 long-term debt was USD6.1 billion. The size of their debt jumped particularly significantly in 2014 by 121% to USD3.8 billion. Over the five-year review period the CAGR was 63%, up from just USD881 million in 2012.

According to Priceline, consequences of their debt could be:

- Take a portion of their cash flow from operations and capital expenditures.
- Increase their vulnerability.
- Reduce their ability to obtain additional financing on acceptable terms.
- Decrease their flexibility when planning for or reacting to changes in their business or the industry.

4.

Mergers and Acquisitions

The Priceline Group have introduced a range of brands to their family over the last 20 years. Priceline's acquisition of Booking.com in 2005 has driven a major part of their financial success, particularly due to their ability to capture the fragmented European accommodations market. The resulting cash gave Priceline financial strength to buy some of the competition and invest in other growth opportunities.

Booking.com has easily been the most successful of Priceline's acquisitions and represents Priceline's general philosophy towards M&A. Compared to other major players in the digital space, Priceline has not been as acquisitive, preferring to make careful investments on strong growth prospects which can add to their bottom line rather than outright buying up nearest competitors. The independent management of their brands helps them remain agile and adaptable to changing consumer demand and market dynamics. This outlook and structure does not mean that Priceline will not feel the need to add to or adjust its portfolio, however. Booking.com's strength is a marker of success but it does leave the company leveraged towards the brand and the accommodation sector. The overall online travel environment is also highly competitive. Priceline and its associated brands will therefore most likely look to make acquisitions that they can incorporate to enhance their brand offerings, particularly from a technology perspective. Otherwise, Priceline seems most likely to step up its holdings into its promising Chinese investments of Ctrip and Meituan Dianping.

The Priceline Group brands currently are:

priceline.com: This is heavily focused on the US and more of a metasearch tool for all travel products. Whilst this might be a namesake brand, it is not the company's most important website in terms of revenue. It was until recently famous for its opaque travel reservation business Name Your Own Price and Express Deals, but, as we have established, demand for this opaque product is declining and their focus has changed.

Booking.com: This is focused on hotels in Europe and their most important site contributing the majority of revenues to the group. It is also a competitor in the alternative accommodation space, listing a growing number of vacation rental properties.

agoda.com: This is similar to Booking.com but focused on the APAC markets and based in Singapore. It operates primarily on the merchant revenue model, unlike the rest of the OTA brands.

rentalcars.com: This competes with Expedia's carrentals.com and, whilst generating both merchant and agency bookings, including opaque, margins are low. The car product does, however, enable package products and helps service the entire customer trip.

OpenTable: Is a website and a mobile app focused on restaurant reservations targeting in-destination sales, charging a flat fee for all bookings. The brand was established in the US, but the network was recently expanded into Europe as growth potential there is considered particularly significant. It has not yet performed as they hoped so they have adjusted their short/long-term approach recently.

KAYAK.com & Momondo: This brand brought click-based advertising revenue into the group and good profit. It also brought an in-house marketing arm to priceline.com, Booking.com, agoda.com and rentalcars.com, which was becoming an increasing proportion of the advertising mix. Since the acquisition, they have been transforming it from a US brand into a global one, particularly in Europe, hence the acquisition of Momondo, which has been folded into the KAYAK arm of the business.

4.1 Major Milestones for Priceline

1997	Priceline.com	Priceline.com launched with Name Your Own Price
1999	Priceline went public	Priceline initial public offering reaching USD12.9 billion market value on the first day
2003	Priceline.com - air products	Priceline's Name Your Own Price enters retail air space
2004	TravelWeb	Acquired majority share and entered the retail hotel business – USD20.8 million plus 954,547 shares of common stock – then 100% ownership
2004	ActiveHotels.com	Acquired a then leading online hotel booking service in Europe for USD161 million
2005	Booking.com	Acquired Booking.com B.V. the leading hotel booking website in Europe for USD133 million and combined it with ActiveHotels
2007	agoda.com	Acquired Asian-based leader in hotel reservation and discount bookings in Southeast Asia particularly for around USD156 million
2010	rentalcars.com	Acquired TravelJigsaw a multinational rental car service today known as rentalscars.com – the price was approximately USD109 million
2013	KAYAK	Acquired KAYAK for USD1.8 billion, a global travel search technology company or metasearch site
2014	The Priceline Group	Priceline changed to The Priceline Group with multiple independently managed brands
2014	OpenTable	Acquired OpenTable Inc, the online leader in restaurant reservations, for USD2.4 billion.
2014	Buuteeq and Hotel Ninjas	Acquisitions of these digital hotel marketing services are estimated to have been purchased at a combined USD98 million
2014	Qlika	Acquired Israel based micro-targeting start-up to support Agoda in localisation and paid search campaigns – they bought it for an estimated USD15-USD20 million
2014	Ctrip	Strengthened its commercial partnership by investing USD500 million for access to accommodations in the Greater China region. Ctrip has access to Pricelines global accommodation portfolio
2015	PriceMatch	Acquired PriceMatch, a cloud-based data and analytics solution for hotels to support revenue management
2015	RocketMiles	Acquired RocketMiles, a Canadian-based company that allows consumers to book hotels with airline miles, for about USD20 million
2015	ASDigital	Acquired ASDigital a leader in Australia for restaurant reservations and B2B software
2015	Ctrip	Invested an additional USD250 million in Ctrip via a convertible bond – and then could gain up to 15% stake in Ctrip
2017	Momondo Group	Signed on February 2017, the agreement acquired the Momondo Group, which operates metasearch website Momondo and Cheapflights, for USD550 million
2017	Evature	Priceline acquires small Israeli start-up Evature for an undisclosed sum in September 2017. Evature's expertise is in natural language processing for AI travel advisors.
2017	Meituan-Dianping	Priceline invests into rising Chinese tech company Meituan-Dianping in October 2017 during Series C funding worth USD4 billion. The move allows Agoda and Meituan Travel to partner.

4.2 Key Recent Acquisitions or Investments

4.2.1 The Momondo Group

Priceline plans to use USD550 million of its international cash to fund this acquisition. It is their biggest acquisition since OpenTable. The deal is expected to close later in 2017. This acquisition hopes to enable Priceline to capture a younger demographic in Europe and drives business in areas where KAYAK is less strong, such as the UK and Nordics. It also helps compete with tough competition from UK-based Skyscanner, which was recently acquired by Ctrip.

4.2.2 OpenTable

This was a USD2.4 billion transaction funded by cash on hand in the US and USD995 million borrowed under their revolving credit facility which the company repaid during Q3 2014. ASDigital, a later acquisition, is being integrated into OpenTable which will help build its presence in Australia, Japan and other markets across APAC.

Thus far, OpenTable could be said to be the company's least successful acquisition and even if they achieve great success with OpenTable sales, it will be a long time before it comes close to the hotel business. They have been investing more in long-term growth to new markets which has affected shorter-term profit margins and earnings. In Q3 2016 OpenTable modified its strategy to tackle the limited progress made, and, whilst they will continue to invest in international expansion and other growth initiatives, this will be more measured and deliberate. Priceline have reduced their forecast long-term financial results and offset that by improved earnings and profit from reduced investments.

4.2.3 Ctrip

Their commercial relationship began in 2012 and, whilst Priceline clearly has a vested interest in Ctrip, it is not solely dependent on Ctrip for its expansion plan into China as they have been building a local presence staffed by bilingual customer service reps. Booking.com have been increasing their properties rapidly in China and are also eying up Chinese travelers as a source market for their European destinations.

However, in 2014 they invested USD500 million into the site, which has similar travel booking options to Priceline. In 2015 they invested a further USD250 million, which put their stake into the company at 10% and gave them an observer on the Ctrip board. They also agreed a strategic partnership in which Booking.com and agoda.com will supply much of the inventory of hotels to Chinese users when booking through Ctrip. Ctrip's subsequent investment into Qunar gives Priceline a hand in both of China's most powerful online travel players and the demise of the Expedia-backed eLong further strengthened Ctrip. This is a critical link to the world's largest outbound market and what will soon become the world's largest travel market full stop.

4.2.4 Meituan-Dianping

Meituan-Dianping is a major player in the Chinese tech scene, bringing together group buying, booking and reviews capabilities, and a rapidly rising power in the Chinese online travel scene. It is now thought to be behind only Ctrip and Qunar. Reportedly, Meituan-Dianping recorded more than 18 million room night bookings in July 2017 alone, an increase of 50% year on year for the month (China Travel News, 2017). This has therefore made it an attractive prospect to Priceline, which has bought into the company through Series C funding announced in October 2017. Not only does Priceline now have an undisclosed slice of a start-up reputedly valued higher than Airbnb, but it also announced that it was to create a distribution partnership between the company and Priceline's main Asian arm, Agoda. A Meituan-Dianping press release following the funding stated: "In addition to welcoming The Priceline Group as a new investor in the current funding round, Meituan Travel, Meituan-Dianping's travel and leisure platform, has entered into a new strategic partnership agreement with Agoda.com, a global online accommodation reservation company under The Priceline Group, to create a mutually beneficial commercial relationship between both companies." (Meituan-Dianping, 2017) This deal will further enhance Priceline's competitive edge and distribution network within China and is one to keep an eye on in the future.

4.3 M&A Outlook

The Priceline Group are open to acquisition deals but they are more focused on organic growth than gobbling up too many competitors at great pace. As the market evolves, their needs are likely to change so we do expect further acquisitions. TripAdvisor might be a key addition to enrich their entire customer journey offering, but we do not really expect this specific acquisition to take place.

They aim to drive overall growth through geographic diversification and into new lines of business. Their stake in Ctrip and investment in agoda.com are indicative of their drive to grow business in the APAC markets and the diminishing returns in North America mean that Priceline will likely double down on growth in Europe and Asia. Expedia's interest in Asia-Pacific may spur Priceline to make investments into smaller regional players, but Priceline has the competitive edge currently with its investment into Ctrip. Ctrip also has investments in key Chinese and Indian players Tuniu, Tujia, Qunar, and MakeMyTrip, so Priceline can get even stronger in the region by stepping up its holding in Ctrip. It can also increase its holding in Meituan-Dianping, a challenger to Ctrip and a company that is rumored to be heading towards an Initial Public Offering (IPO) in the not too distant future.

OpenTable and its significant price indicates their dedication to the in-destination segment too. The recent acquisition of Momondo suggests the growing importance of metasearch and their desire to capture more advertising revenue whilst controlling key marketing outlets for their OTAs. There is talk of a potential shift into managed business travel by either acquisition or other ways.

Booking.com is, alongside hotel brands, distributing alternate accommodations and their expansion of inventory seems pretty aggressive in a mission to compete with Airbnb and HomeAway. Whether they maintain this segment under the Booking.com brand or not is debatable but the vigor with which they have targeted the segment increases the probability of Priceline acquiring companies that provide services around alternate accommodations.

Given Priceline's prior history in the M&A field, current investments and strategic priorities, it seems most likely that it will look for bargains in the tech field that can add to its expertise, such as Booking.com's recent purchase of Israeli semantic search and natural language processing specialist Evature, and also to invest in key regional players with proven track records that it can embed to strengthen distribution.

5.

Market Share and Competitive Landscape

The Priceline Group competes globally with the online and offline travel and restaurant sectors, to maintain and grow their share of online leisure/corporate bookings. Their global market position is currently very strong, business growth has continued, and scale is one of Priceline's key competitive strengths.

Priceline use six different independently managed brand names to capture different stages of the travel buying funnel, different channels and different markets around the world. This has strengthened their competitive edge over time to provide a complete experience for travelers and helps them keep hold of the travel customer along the buying lifecycle. KAYAK and the now incorporated Momondo tackle the search and booking of flights, Priceline.com and Booking.com for accommodation reservations, rentalcars.com for transport on arrival and OpenTable for mobile restaurant reservations. By far and away the largest element of the business is Booking.com, which is the online accommodation reservations market leader and skews the business heavily towards accommodation sales.

5.1 Competitive Landscape

According to Priceline at the end of 2016 their key competitors in the table.

Online travel reservation services	Expedia: Expedia, Hotels.com, Hotwire, Orbitz, Travelocity, Wotif, Cheaptickets, ebookers, HotelClub, RatesToGo and CarRentals.com
	Hotel Reservation Service (HRS): Hotel Reservation Service and hotel.de
	AutoEurope and CarTrawler – in which they hold a minority interest
	Ctrip – they hold a minority interest
	eLong (Ctrip have a minority interest)
	Recruit: Meituan, ezTravel, MakeMyTrip, OYO Rooms, Yatra, Cleartrip, Traveloka, Webjet, Rakuten, Jalan
	ViajaNet, Submarino Viagens, Despegar/Decolar – in which Expedia hold a minority interest
	Alibaba: Fliggy
	17u.com, HotelTonight, CheapOair, Mr. and Mrs. Smith and eDreams ODIGEO
Online non-hotel accommodation search / reservation services	Airbnb
	Expedia – HomeAway
Large online companies – e-commerce and internet traffic	Google
	Facebook
	Alibaba
	Tencent

	Amazon
	Baidu
	Groupon
Traditional travel agencies, TMCs, wholesalers and tour operators (with physical locations)	Carlson Wagonlit
	American Express
	BCD Travel
	Concur
	Thomas Cook
	TUI
	Hotelbeds
	Tourico (which Priceline have agreed to merge)
	Kuoni
	Independent travel agencies
Travel suppliers direct bookings	Accommodation providers
	Car rental companies
	Airlines
	Room Key
Metasearch	TripAdvisor
	trivago (Expedia)
	Qunar (Ctrip)
	Skyscanner (Ctrip)
	Google Flights and Hotel Ads
	HotelsCombined
Online restaurant services	LaFourchette (TripAdvisor)
	SeatMe (Yelp)
	Zomato
	Bookatable (Michelin)
	Quandoo (Recruit)
	Rest (Airbnb have a minority investment)
Car rental and car sharing businesses	Uber
	Lyft
	Gett
	Zipcar (Avis)
	BlaBlaCar
	Didi Chuxing
	Ola
	TripAdvisor, Google etc

5.2 Market Share

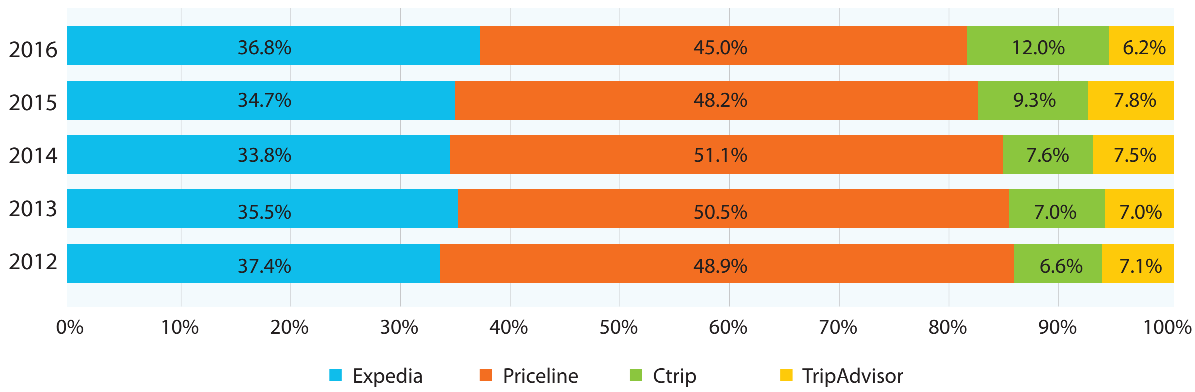
Priceline is a powerful presence in all major global travel markets, but it is outside the US where Priceline has forged ahead, as rivals concentrated more on the US market in earlier days. Their strategic acquisitions of Booking.com and KAYAK have expanded their offering and fended off competitors.

In the US, Expedia are Priceline's biggest rival, and even more so since their recent acquisition of Travelocity and Orbitz. They compete in the US online market mainly for airline tickets, car rentals and package services. They consider themselves a 'challenger brand' in the US as Expedia and all their well-known brands have dominated the hotel retail sector, and have growing strength in the vacation rental market too. Their marketing approach to the US going forward is going to be highly US-specific in an attempt to win the consumers and grow their brand in this market.

Combining the four big players in terms of revenue, Priceline has maintained the largest share, although both Expedia and Ctrip have eroded this somewhat in the last two years. In 2016 Priceline contributed 45% of all revenues generated from these four companies, against 37% for Expedia and 12% for Ctrip. TripAdvisor contributed a smaller 8% in 2016.

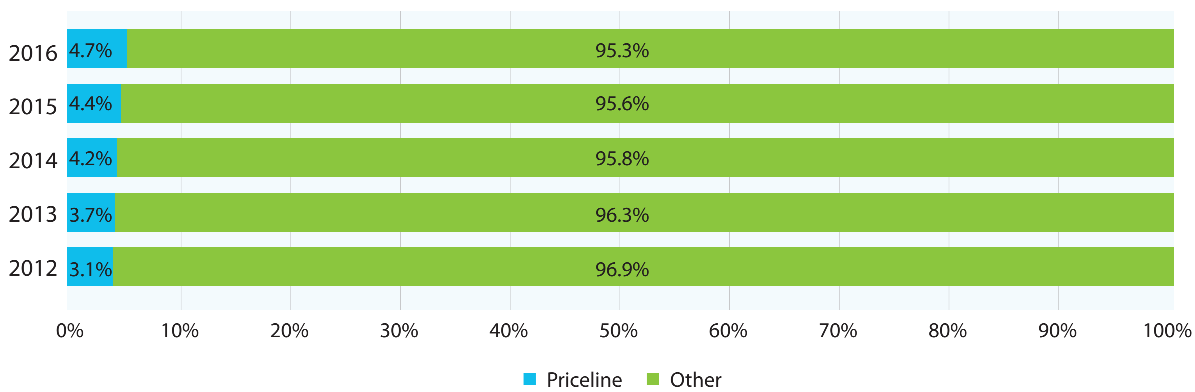
According to EyeforTravel calculations, Priceline's share of the total global travel market has been increasing and in 2016 they accounted for 4.7%. They also gained a percentage point in 2016 for their share of the global online travel market, reaching 18% in 2016.

Figure 27: Comparative Revenue Share of the 'Big Four'



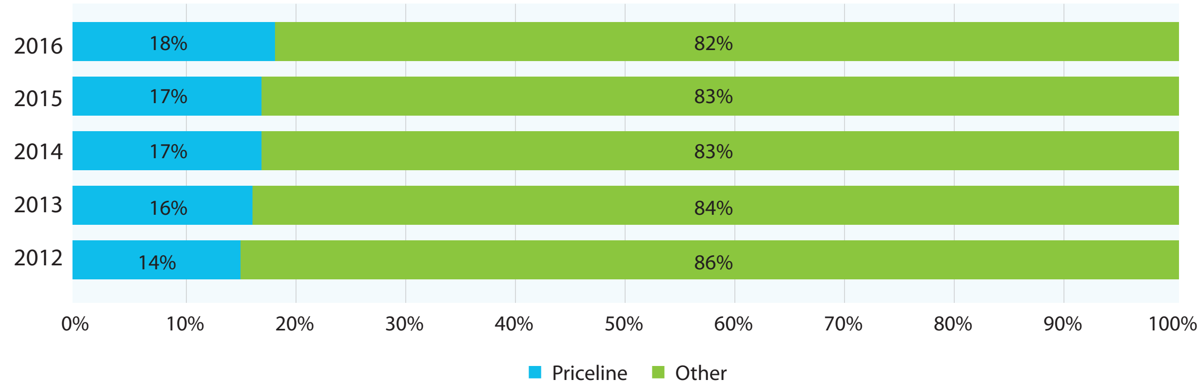
Sources: Expedia Inc., 2017; The Priceline Group , 2017; Ctrip, 2017; TripAdvisor , 2017

Figure 28: Priceline Share of Total Global Travel Market



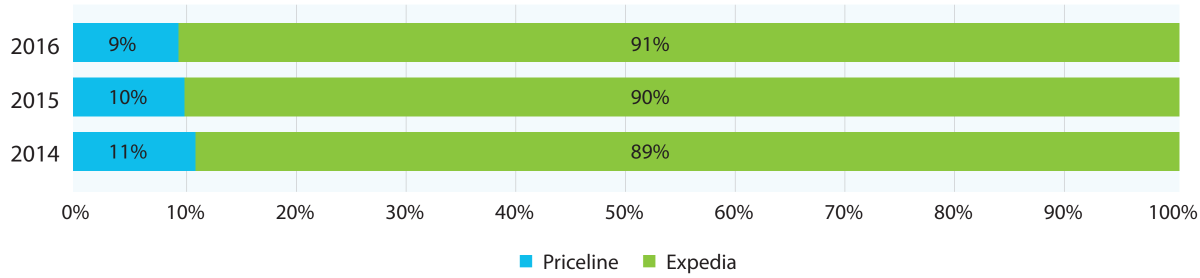
Source: The Priceline group, 2017; eMarketer, 2016; eMarketer, 2016; Statista, 2016;, EyeforTravel calculations

Figure 29: Priceline Share of Global Online Travel Market



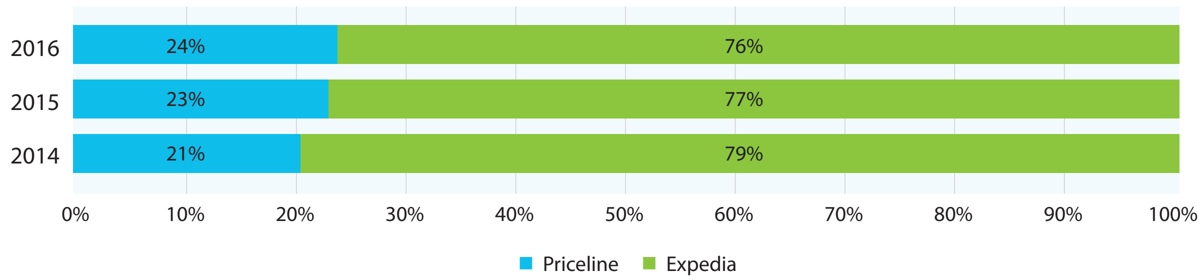
Source: The Priceline group, 2017; eMarketer, 2016; eMarketer, 2016; Statista, 2016;, EyeforTravel calculations

Figure 30: Priceline Market Share of US Online Travel Market



Source: The Priceline group, 2017; eMarketer, 2016; eMarketer, 2016; Statista, 2016;, EyeforTravel calculations

Figure 31: Priceline Share of International Online Travel Market



Source: The Priceline group, 2017; eMarketer, 2016; eMarketer, 2016; Statista, 2016;, EyeforTravel calculations

In the US their presence is smaller than the international markets and US market share has been declining over the last few years. In 2016 they had a 9% share of the US online travel market. The international online travel markets tell the opposite story with a growth in market share from 21% in 2014 to 24% in 2016.

The global travel industry is highly fragmented which offers Priceline, as an online travel leader, a lot of room for growth. A growth in market share of the international online travel market equates to significant figures.

In Fogel's words, "We will continue to focus on growing our supply base to drive customer choice, innovating around the customer experience and investing efficiently in marketing to deliver profitable top-line growth."

5.3 Key Competitors

5.3.1 Inside the Vertical

Expedia is Priceline's biggest direct rival at the moment. Expedia tops Priceline in terms of gross bookings, by USD4.3 billion more in 2016. Priceline tops Expedia in terms of revenue, generating USD1.2 billion more in gross revenue in 2016. Priceline overtook Expedia's size in 2010 in the latter field.

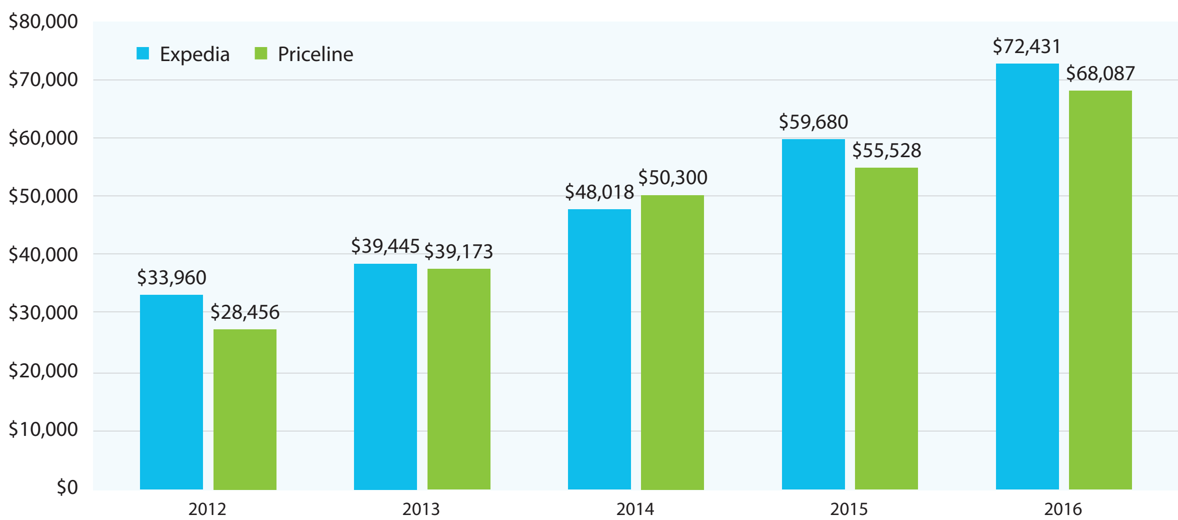
Although Expedia are more diversified and have more gross bookings, Priceline now book around double the number of room nights per year compared to Expedia. The two companies certainly compete for customers but their financial results and models are still quite different. Priceline, for example, generate far more agency bookings than Expedia, who generate a greater proportion of merchant bookings. This means Expedia have more control over prices and supply conditions but Priceline are able to generate higher profit margins with much lower cost of inventory on sales. Booking.com is their key competitor brand against brand Expedia and HomeAway (owned by Expedia Inc.). Priceline have succeeded in rapidly expanding their inventory supply as part of their growth strategy. Priceline exceed competitors in organic growth and this offers a significant competitive advantage. Expedia in comparison have been driving their growth through acquisitions.

International exposure has also opened Priceline to faster growing and potentially huge travel markets, greater than the market potential of the US. Expedia is more focused on the US, with a lot less strength in the international markets compared to Priceline, with a notable weakness in China compared to Priceline.

International markets are also more fragmented than the US which provides a significant opportunity for Priceline as they can offer more value to smaller players than larger players. These international markets do potentially have stability risks due to the economic and geopolitical climate which could cause their growth to subdue. In the last couple of years Priceline have been pretty resilient to these external issues so the benefits are likely to significantly outweigh the costs.

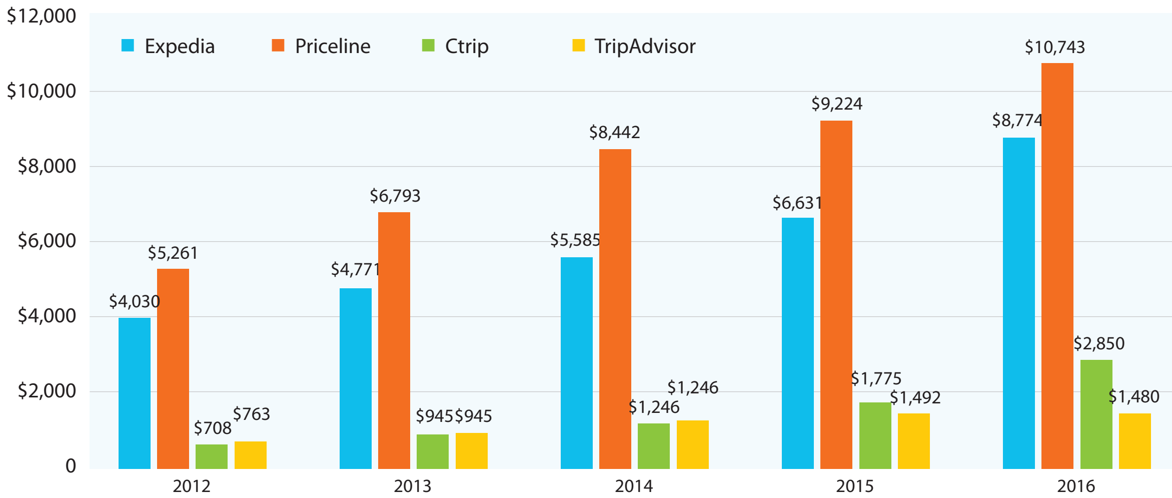
TripAdvisor and Ctrip are the next biggest direct competitors and could create greater competition in the next few years but the difference in annual revenues is currently significant. Ctrip is, however, the second largest online travel company in terms of market value. The future of Priceline's stake in Ctrip is an interesting debate because, as a key competitor, Priceline may also benefit from their growth in other ways. The purchase of UK-based Skyscanner by Ctrip has, however, pushed Priceline to acquire European metasearch brand Momondo as they compete, not just as a pure OTA, but in other increasingly important areas of the travel

Figure 32: Expedia Versus Priceline Gross Bookings (USD Millions)



Source: The Priceline group, 2017; Expedia, Inc, 2017

Figure 33: Revenues for the 'Big Four' (USD Thousands)



Sources: Expedia Inc., 2017; The Priceline Group , 2017; Ctrip, 2017; TripAdvisor, 2017

funnel, some of which are shifting into OTAs.

Priceline have their eyes on a range of competition within and outside their vertical. Some of these are discussed below.

5.3.2 Outside the Vertical

Travel Suppliers

Hotels, car rental companies and airlines would ideally prefer bookings to be made direct to their websites to cut OTA distribution costs. If travel suppliers increasingly charge lower prices and offer advantages via their loyalty programs or other closed user groups, they might create more attractive offers than OTAs have the ability to do. The consolidation in the hotel sector, such as the Marriott-Starwood merger, could raise their negotiating power for commissions as well as incentivize consumers to join enhanced closed user groups. Discounting could increase amongst suppliers as competition authorities seek to allow increased pricing flexibility, and Priceline may be pushed to enter the price war which would impact their profitability. Potentially Priceline will need to consider enhancing their strength in enticing consumers to closed user groups themselves to compete; however, their strength in servicing smaller independent accommodation suppliers, who are far more reliant on the booking giant, will reduce vulnerabilities in comparison to Expedia. Nonetheless, Priceline's reliance on Booking.com and the accommodation sector is higher than Expedia's, so a major shift across the accommodation sector to protect inventory could be particularly painful. This seems highly unlikely currently, however.

Metasearch and Search

With its broad travel search results, metasearch is increasingly popular amongst travel consumers because the range of search results often beats the availability offered by OTAs. Metasearch results can also assist their competitors in raising consumer brand awareness. This could lead to such companies gaining a larger share of search traffic which is dangerous for companies like Priceline. Traffic is one of the main areas Priceline compete fiercely in, both directly and indirectly. TripAdvisor and Google, for example, are established companies with substantial resources and expertise in e-commerce and facilitating internet traffic. They have more recently shifted into from an information provider role to travel metasearch and reservations bookings, thus making inroads into the online travel market across the world. It drives direct competition for consumers between travel suppliers, OTAs and other travel service providers.

TripAdvisor and trivago are two of the leading travel metasearch companies at the moment and invest significant budgets in brand and performance advertising. Priceline's KAYAK brand competes directly with other metasearch services. However, whilst KAYAK may pick up some of the lost revenue from a reduction in OTA bookings, it may not result in balancing profit gains. If metasearch services do evolve further into travel reservations, i.e. bookings made without leaving the website, such as TripAdvisor's 'Instant Booking,' then they will compete directly with their OTA brands. Priceline have been participating in TripAdvisor's Instant Booking since October 2015, but it could cannibalize business that would otherwise go direct to them. They have agreed to display some of their accommodation properties.

The growth in this sector is likely to lead to some pressure to spend more on advertising or other customer acquisition costs to grow their business. It also lowers the cost of distribution for other industry competitors and promotes the brands of new entrants, taking consumers away from their business.

The main issues raised by competitor metasearch brands are:

- Reduced traffic to their travel reservation sites.
- Increased consumer awareness of competitor brands and sites.
- Increased advertising and other customer acquisition costs.
- Pressure on bookings and margins.

Google lead in terms of search popularity. If Google change their algorithms or expand into travel distribution it will have enormous impact on their traffic. Other traffic gatekeepers such as Facebook could also influence their future success in competing for travel consumer internet traffic, and ultimately the booking.

Alternative Accommodation Providers

Airbnb and HomeAway present the greatest competitive threat to Priceline's vacation rental segment. They are two growing brands focusing on this niche. The success of these sites is also likely to lead to an evolution in their models; for example, Airbnb may add hotel and flights through their online and mobile platforms. Priceline is bigger than Airbnb, but Airbnb are putting up a fight with their innovative marketing tactics and product development, and they are both competing for the complete consumer travel experience. Priceline have some work to do in this area to defend the disintermediation of this sector; however, they are expanding rapidly into this segment by expanding their vacation rental inventory on Booking.com significantly in 2015, 2016, and 2017.

Restaurant Bookings

OpenTable is a leader in North America, with over 50% market share (ref). TripAdvisor has led the restaurant booking market outside the US with its acquisitions over the years. Priceline's OpenTable acquisition could provide additional competition to TripAdvisor in international markets. These two are likely to battle out the growth of this sector outside of the Chinese market, but this will affect Priceline's profitability as TripAdvisor is very well established in both web and app usage.

Corporate Travel

BookingSuite is a Booking.com tool linking corporate travelers with their company accounts and is driving growth in the B2B travel sector. It seems Priceline are looking more closely at the corporate sector and it is expected they will look to compete more heavily for corporate customers in the coming years. Egencia, owned by Expedia, is a step ahead of them in this sector and above are listed the other competitors in the segment.

Technology, Mobile and the Big Tech Players

The big players could build upon their strength in mobile to favor their own travel reservation services. Google could leverage its leading Android operating system to create competitive advantage for its travel services. Apple obtained a patent for iTravel, a mobile app that would allow a traveler to check in for a travel reservations and act as a virtual wallet for travel. It is an indication that they may move further into the travel reservation space. Apple's expertise in mobile apps is over and above Priceline's. They may also expand Siri, their voice recognition service, and Apple Pay. Priceline are experimenting with AI technology, such as Amazon's Alexa and Booking Messages, a chat tool which connect with hotel front desks. Their continued innovations and partnerships to drive their technology strength will be key to remaining competitive.

6.

Dominance or Decline?

6.1 Future Prospects

Summary

- Priceline is a juggernaut with enormous power and a history of strong recent growth, particularly in its earnings, the growth rate of which outpace not only direct competitors, but almost anyone else in the digital space.
- It currently has a competitive edge against its major OTA rivals and its investment strategy has enhanced its market position, particularly in Asia-Pacific. However, it is struggling in the US market.
- Strong profitability and cash flows means that it could quickly make a major investment or acquisition if it felt compelled, although this is not Priceline's general style.
- Huge advertising outlays primarily go towards Google, a potential future rival that has a lot of power over Priceline's Booking.com as a driver of traffic. These marketing costs show no real signs of slowing down but marketing effectiveness does not seem to be rising to the same degree.
- It is reliant on the accommodation sector and therefore its relationships with suppliers are absolutely key – relationships that have often been fraught.
- Competition authorities also have a negative view of Booking.com's influence, particularly in Europe, which may mean the regulatory framework moves against the company and its interests.
- Priceline has a very strong technological base and framework to work with. It has been able to streamline the online customer experience extremely well.
- Its mobile capabilities are another competitive advantage, although TripAdvisor is also strong in this realm and OpenTable may struggle to compete outside the US.
- Overall, Priceline is reliant on accommodations and is operating in a competitive space but its network of investments, wide geographical reach, technological capabilities, large inventory, high profitability, strong business model, and careful management make it the leading player in the space and difficult to dislodge. Its main danger is if another major player in the tech industry decides to really focus on online travel. Principally this is Google, but as Priceline is certainly one of its top advertisers, there is a disincentive to move in a major way in the immediate future.

It's hard to argue with Priceline's recent strategy. Smart investments, a commitment to product optimization, and a business model that can be scaled profitably make it not just one of the top-performing brands in the online travel space, but in all of tech.

This doesn't mean it is invincible, however. Whilst Booking.com is a juggernaut of a brand, Priceline is intensely reliant on this core brand and its other business lines pale into insignificance standing next to lodging. This gives Expedia and TripAdvisor a slight competitive edge in insulating themselves from disruption to the sector as they generate more of their revenue from other verticals. It also means that the Booking.com brand will need to remain resilient and well-managed. Nonetheless, it is hard to see a direct competitor overhauling Priceline in the near future, barring a major scandal, disruption or regulatory ruling from a competition body.

The key to this strength and future growth is its global positioning. Near the top of every market's most visited travel websites is a Priceline brand. While Booking.com is global competitor and leader, there is also priceline.com and KAYAK in the US, Agoda in Asia-Pacific, and Momondo in Europe. The biggest advantage looking forward, however, is Priceline's position in China. The biggest direct competitor outside of Expedia currently is Ctrip. This risk is negated by the strategic investment Priceline has in the company. Even better for Priceline is that, by extension of Ctrip's own investments, they are beneficiaries of growth in other key regional players, such as MakeMyTrip, Qunar and Tujia. Priceline's decision to invest into Meituan-Dianping shows it is not sitting still in this regard and is willing to invest into competition if it seems promising enough. With both of these companies, Priceline also has inventory-sharing partnerships, extending its distribution network, intensifying its links with the partner companies and strengthening the competitive advantage they hold over Expedia in Asia-Pacific, which will be the home to the fastest growing travel markets in percentage terms.

Its main weakness in terms of geographical markets is the US. Expedia's strategy to buy up the last remaining major competitors in the online travel space appears to have succeeded in consolidating the market for themselves and seems to be diminishing Priceline's market position. In 2016 Priceline's revenue derived from US sales and gross bookings from the US market, both declined. Revenues fell by -8% and gross bookings reduced by -2%, emphasizing the issues in competing in Expedia's backyard. Meanwhile, Hitwise data projected that Expedia's own brand site was the main winner in the US OTA market, with bookings growing by 10% in May 2017 compared to May 2016, whereas Priceline.com declined by -8% and Booking.com, grew by a more modest 4% and remained behind Expedia.com for market share.

Trying to fight back in the US market will also be difficult, as Expedia.com has a very strong position and major ad spending may not have enough of an effect. Already Priceline is a bigger spender than Expedia on online marketing and Booking.com is more reliant on non-organic traffic than Expedia.com. This suggests that extending marketing efforts in the North American market to try and claw back market share will have limited success against the Expedia Group and its brands as Priceline is likely reaching the point of saturation and diminishing utility. Spending for both groups on advertising in their financial releases rose to a combined USD6.5 billion in 2016, nearly 60% of which was spent by Priceline. This shows no signs of slowing, with marketing spend by Priceline growing by 22% across the first three quarters of 2017. In percentage terms this matches a 22% increase in the broader 'selling and marketing' element of Expedia's costs across the same time frame (see Section 3.1 for more).

Even with this spend, Expedia.com (Expedia's main US brand) remains ahead when compared to Priceline's primary brand, Booking.com for generating organic search traffic (search being the largest component of marketing spend). For the domain Expedia.com, 77% of traffic was organic in January 2017 and 23% paid, falling to 75% and 25% in September 2017 and October 2017. In contrast, Booking.com found itself paying for 55% of traffic in the January snapshot, 49% in September, and 50% in October 2017 according to the SimilarWeb data (SimilarWeb, 2017a; SimilarWeb, 2017b). It is therefore difficult to believe that pumping substantially more money into the North American market will turn market shares around in a significant manner and would likely be a damaging fight for Priceline, which is more likely to prefer on building its international profile – an international profile that gives it an overall edge on Expedia.

The additional competitive pressures that affect the marketing balance will not be welcomed by Priceline or its shareholders. Indeed, after Q3 2017 earnings were released, Priceline shares took a beating on the back of announcements that the company was to step up marketing expenditure and earnings missed analyst expectations. Following the Q3 earnings call on 6th November, shares fell by 13% on 7th November. This mimicked a similar stock drop following the Q2 earnings call, highlighting investor concerns at spending levels on marketing and the return on investment that Priceline is achieving.

Not only is this vast marketing outlay diminishing the bottom line but it is strengthening a potential key future competitor in Alphabet and Google. Already the marketing spending Alphabet generates from the travel industry makes them, in revenue terms, the world's largest travel company, and there can be little doubt that the biggest single contributor to this is Priceline's search marketing efforts. In some ways, however, this insulates them from too much competition from Google as the revenues, and margins in particular, are unlikely to be matched in the short term by muscling into the OTA business too directly. Also, Priceline's ability to spend and optimize keywords is unmatched, giving it a competitive advantage in this sphere. That being said, it must concern executives at Priceline that they may be feeding a beast that has consistently added to their travel portfolio in the form of Google Trips and consistently revamping the features on its Google Flights and Google Hotel Finder metasearch products. Google's emphasis on the metasearch area may help explain the acquisition of Momondo by Priceline and a recent emphasis on growing KAYAK. If consumers move over to using voice and AI assistants more frequently for travel searches then this may further diminish Priceline's ability to influence the consumer.

The rises in ad spending are further exacerbated by the fact that there are not only are there pressures to up advertising spend from direct competitors but also from the suppliers, whose position has strengthened recently, leading them to invest in marketing and fight for consumer loyalty. Book direct campaigns have been launched by a wide variety of brands, with varying success. Overall though, it seems to be the case that suppliers are in a far better state than during the previous global recession and are growing far more confident in defending their brands' and inventory. This can be seen in more conciliatory negotiating positions, better contracts for suppliers and also a growing number of products designed to cater for their requirements.

Suppliers are pushing book direct as Booking.com's power in the accommodation market is seen as often creating an over-reliance on the giant to derive bookings, particularly for smaller brands and independent operators. Booking.com has also often stridently moved to defend its influence and market position, creating tension with suppliers, who of course control the key product and also regulatory bodies.

Some of these regulatory bodies now appear to have negative views on the brand and have even begun to act in a concrete manner. This means the regulatory environment is a risk that needs to be appreciated by Priceline. Already a number of European countries have moved to ruling to varying degrees against price parity clauses the major OTAs had in place, such as in Austria, France, Germany, Ireland, Italy, and Sweden. These vary between harsher rulings, such as in Germany, where courts have ruled against all price parity agreements, to more common rulings where so called 'wide' price parity agreements have been changed to 'narrow'. This essentially means that OTAs can now no longer obtain most favored status, where they can demand the lowest available rates no matter where they are displayed, and instead hotels can differentiate prices between OTAs and offline channels.

The attempts by Booking.com to challenge legal rulings against narrow parity clauses indicates the damage they feel this can potentially do to its business model and underlines the possibility for disruption if hotels become more strident in pursuing competitive practices and lobby for change. A major study by the European Commission found that nearly half (47%) of hotels surveyed were not aware of parity changes and 79% had not yet differentiated pricing between OTAs (European Commission, 2017). If accommodation suppliers then move to more price differentiation as they become more aware of their rights, then it will mean a more complex and competitive environment for Booking.com, as well as the OTA market in general, that will place downward pressure on commission rates and potentially lure customers away from Priceline brands.

At the time of writing, further cases of note include those in the UK, Switzerland, and Turkey. The UK authorities announced in October 2017 that they were investigating whether hotel bookings sites were misleading consumers and their areas of interest – rankings, push notifications, hidden charges and claims about discounts – seem highly pertinent to Booking.com (FT, 2017b). Swiss authorities opened formal proceedings in against Booking.com specifically in September 2017, citing the giant's unwillingness to negotiate more reasonable commission rates (The Local, 2017). In Turkey, a dispute descended to the point where an injunction was brought by the Turkish authorities in 2017 against Booking.com. This reportedly significantly affected Booking.com's business in the country (Tnooz, 2017).

If scrutiny continues in this vein then there is a distinct possibility of further regulatory framework changes in Europe that could significantly affect Priceline's business, especially if regulators begin to view the dominance of Booking.com in particular as an anti-trust issue.

However, even in an environment that has become more favorable from a number of angles for suppliers, they will continue struggle to compete with the technical and data expertise of Priceline, especially in combination with its vast scale. Priceline's brands have wisely focused on the user experience, using vast testing and data analysis to refine every element of the key pages its users see. Most notably this is can be seen in Booking.com's format and prompts, which result in high conversion rates and have allowed the company to become the most influential player in the online accommodation business.

Ben Bates, Commercial Excellence Manager at Booking.com, speaking at EyeforTravel North American 2017 noted that: "A/B testing is such a critical part of our testing culture at Booking.com. It's such a critical part of how we win the customer." This extends to the point that the company has "approximately a thousand A/B tests live at any given time on any given day," so that "the website is 100% of the time different for every single customer". They extend this down to every detail that has a measurable increase. Bates gave the example of their main search box, where they "saw a 1.7% reduction in bounce rates by just introducing a border" around the box. These kind of changes combine when operating at the scale of Booking.com to make considerable uplift.

However, it is not just A/B testing, as they also run other key measuring techniques, principally:

1. Online survey tools.
2. Street-level user testing.
3. Usability tests.
4. User tests.
5. Diary studies.

These vary in sophistication, from simply testing the product directly with people on the street, to site exit tools and even neurological tests from participants using the site. For the latter Bates explained that "Neuro-user testing … will measure the Emotional Response Analyses – ERA – and it will basically look at the electrical channel that are measured from the surface of the scalp. It will act as a thermometer for what's fighting for dominance inside our brain at any given time and it looks for excitement, attention, and frustration in conjunction," said Bates (EyeforTravel, 2017).

There are almost no competitors that can rival this ability, through either the number of data, design or engineering specialists, the expertise, or the economies of scale Priceline is able to achieve across its brands. It helps to fortify its position as, much like Amazon, most of what Priceline and its brands do is not to be truly visionary in creating new products but to make sure it executes everything well and its entire user experience is highly optimized.

Its technological advantage is further extended by the power of its mobile presence, which is becoming increasingly critical in Western markets and even more so in Asia-Pacific, where the smartphone is already the dominant device in the travel journey. It is the clear winner in the OTA market for app downloads and usage in most markets outside China, with only TripAdvisor really beating out the Booking.com app in major markets when it comes to regular usage. Both TripAdvisor and Booking.com rate above Expedia's core app even in the US in terms of usage on Android devices, according to SimilarWeb, and Booking.com comes just ahead of Expedia in the Play Store's rankings. Similarly, Booking.com's app is the top OTA app in Apple App Store for downloads across major Western European markets (SimilarWeb, 2017c). App Annie figures from August 2017 support SimilarWeb ratings, finding that "Booking.com is a top-five travel application in 68 markets around the world, while Expedia is a top-five travel application in two countries, and metasearch company TripAdvisor is a top-five travel app in 18 countries, according to App Annie on Aug. 8, 2017" (Morningstar, 2017). Hitwise data from September 2017 also found that Booking.com was the top app for installs in the US market in both Play and App stores (Hitwise, 2017). Even within China, that set of investments once again becomes key, with Ctrip the biggest player in the mobile travel space.

It is this excellence in their acquisition strategy, along with refining the user experience and utilizing data, that secures Priceline's near-term future and means its position at the top of the online travel space will be extremely difficult to challenge for some time to come.

Out into the longer term there are risks from competition by the gateholders of consumer access to the online world, a diminishing profile in the US, increased regulatory scrutiny, and a reliance on the accommodation sector. Overall profitability faces pressures from growing advertising outlay and increasing accommodation supplier confidence, helped by a better regulatory environment for those suppliers. However, Priceline's presence in key future growth markets, most notably in China, will help shore up any setbacks in other market places and helps to spread risks. If it can truly establish itself within the vacation rental market and rival Airbnb and HomeAway, then this will provide another strong revenue stream. It can also increase successful investments or make a stronger acquisitive stance if necessary on the back of currently impressive profitability and cashflow numbers.

Nonetheless, we can expect profitability growth to slow down from its excellent average pace of growth over the last five years. This is down to the company's huge size meaning gains are harder to find, marketing costs continuing to rise, and downward pressure continues to occur on commission rates, especially from larger chains in the accommodation space. Even further afield, there is the possibility that blockchain may mean disruption for all third parties acting between customer and supplier. However, in the current situation there are simply few, if any, companies in the space that plan and execute their fundamental strategy as well as Priceline and it is therefore the major power sitting on the throne of online travel at this point.

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