The Priceline Group

CLIENT REPORT

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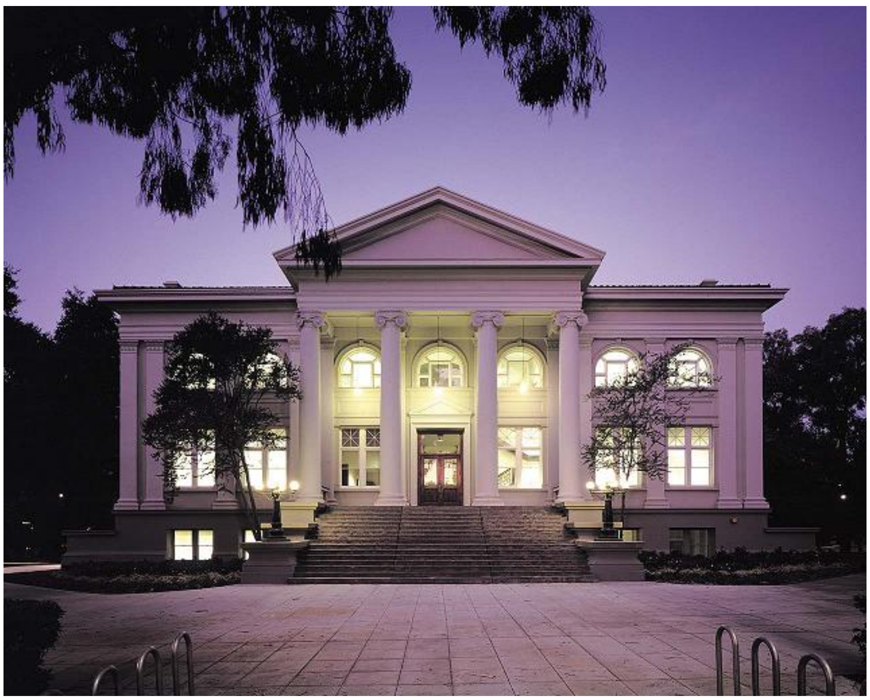

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Executive Summary

The Priceline Group is an online travel company listed on the Nasdaq with a $61 billion market capitalization. The company is known to help users obtain discount rates for travel-related purchases worldwide. The company owns several different websites including Booking.com, which offers worldwide hotel reservation services, Agoda.com, which provides hotel reservation services in Asia, and rentalcars.com, which offers car rental services worldwide.

The Priceline Group operates in the travel services industry, which realized transaction volume in excess of $1 trillion per year. The market is divided into the online market, which realizes 40% of transaction volume, and the offline market, which realizes the remaining 60%. Priceline is the largest travel service agency in the world and has a market capitalization about five times that of the next biggest competitor.

Financially, Priceline is performing very well. It has grown its top and bottom lines extremely rapidly over the past five years of business. It has by far the strongest margins in the industry and manages its capital efficiently. In addition to this, the business has sufficient capital and liquidity to remain in business in the short and medium term.

In order to continue performing at the level that it has been, we at Sontag Solutions have a few recommendations for the business going forward. Priceline should focus on gaining market share domestically by expanding domestic advertisements and investing in the customer experience, better integrating its brands and cross-selling products, and investing in developing markets to capture high returns in the future.

Company Background

History

Priceline dates back to 1997 when founder Jay Walker launched priceline.com with the famous *Name Your Own Price* service. Walker's vision was very successful and in order to raise additional capital, Priceline underwent an initial public offering in 1999, reaching the highest market value, $12.9 billion, of any firm on its first day of trading at that time. During this year, Priceline decided to experiment by selling other goods like long distance telephone services, home mortgages, secondhand goods, and new cars through its coined *Name Your Own Price* service. This idea turned out to be unprofitable, and over the next year Priceline began focusing solely on travel once again.

After losing almost all of its market value in the dotcom bust, Priceline was able to turn profitable in 2001. With a changing dynamic within the firm, Jeff Boyd was named Chief Executive Officer in 2002. Boyd moved the firm in a new direction helping Priceline move beyond the *Name Your Own Price* service and move into the retail air travel space. This turned to be a turning point in the history of the business as there were to be many additional changes to follow.

Notably, Priceline decided to start acquiring other travel related businesses to grow quickly without much expenditure in marketing and sales. Most importantly, Priceline acquired Booking.com and Agoda.com in 2005 and 2007 respectively. Currently, Booking.com is the world's largest accommodations website and the leading hotel booking website in Europe (also the largest source of revenue for The Priceline Group), while Agoda.com is an Asia-based leader in hotel accommodations. In 2004, Priceline entered the retail hotel business through an acquisition of TravelWeb. Later in this year, it acquired ActiveHotels.com, a booking leader in Europe at the time. Other notable acquisitions include the purchase of TravelJigsaw in 2010, KAYAK in 2013, and OpenTable, inc. in 2014.

Along the way, Priceline had several notable milestones. In 2009, Priceline was added to the S&P 500 Index being recognized as one of the largest publicly listed companies. In 2010, Priceline surpassed Expedia to become the world's largest online hotel reservation service. Lastly, The Priceline Group was named a Fortune Most Admired Company. With a combination of strong management and a high value added service, Priceline has become a very admired global company that has guided many millions with their travel related reservations.

Overview

The Priceline Group is an online travel company listed on the Nasdaq with a $61 billion market capitalization. The company is known to help users obtain discount rates for travel-related purchases worldwide. The company owns several different websites including Booking.com, which offers worldwide hotel reservation services, Agoda.com, which provides hotel reservation services in Asia, and rentalcars.com, which offers car rental services worldwide. Under its own name, Priceline.com, the company offers reservation services for hotel rooms, airline tickets, rental cars, vacation packages, and cruise ships through the *Name Your Own Price* service.

Domestically, Priceline makes its money off of Priceline.com, which offers accommodations, rental cars, airline tickets, vacation packages, and cruises, and through its meta-search engine KAYAK. Customers are able to make reservations on the site for all the aspects of their travel plans. Priceline was originally founded off of the Name Your Own Price system where travelers would name their own price for airline tickets, hotel rooms, and car rentals. In this system, the customer is able to select a general location, service level, and price, but the company that is used for the service is not disclosed. Priceline has profited off of this strategy by pocketing the difference between what the customer was willing to pay and the price charged by the hotel. More recently, however, Priceline has made profits off of a strategy that shows consumers prices, but does not disclose the company until after the purchase is made. These strategies have been beneficial for suppliers, since it allows them to rid their excess capacity without disrupting their pricing strategies.

Internationally, Priceline makes the majority of its money through its brands Booking.com and Agoda.com. Booking.com is the world's largest accommodation service headquartered in Netherlands, and Agoda.com does accommodations as well, focusing in Asia. In addition, Priceline makes money internationally through RentalCars.com. The combination of the revenues these companies generate is the majority of the revenues the company makes as a whole.

Regarding its strategy, Priceline is focused on reaching several goals that are aligned with profitability and the best interests of the shareholders. Most notably, Priceline strives to offer a better customer experience than any of its competitors. Priceline looks to make its services easy to use and intuitive so that all customers can easily navigate its sites. In addition to this, Priceline focuses on customer service, a necessary selling point for many customers, through call centers and websites.

Another main focus of Priceline is to maintain multiple, independently managed brands so that it can reach out to a wide customer base with varying preferences. Priceline's core strategy is to own several brands, grow them organically, and purchase additional brands if there is a strategic opportunity. Revenue is split widely among the brands and so it is important that Priceline manage the image and integrity of its brands. In order to build many brands, Priceline spends resources on advertising, expanding operations, and innovating through technology. Over the years, these areas of focus have become strong and durable competitive advantages for the firm.

Priceline's Brands

Booking.com is the world leader in online booking accommodations. It helps business and leisure travelers with varying spending thresh-holds find and book travel reservations all around the world. It seeks to provide the best value for all kinds of properties including hotels, bed and breakfasts, apartments, villas, and even igloos and tree houses. The site is available in 42 languages, offers over 600,000 accommodations in 200 countries, and displays customer reviews of properties. Booking.com provides its own in-house customer service team to provide the best customer experience.

Priceline.com focuses on providing ways to save by offering more deals than any other travel site. Priceline is a one-stop-shop for many different aspects of the travel experience. It offers bookings for hotels, rental cars, and flights. Priceline is widely known for its unique products: *Express Deals, Tonight-Only Deals,* and *Name Your Own Price* service.

KAYAK focuses on making online travel better. The site and app help guide customers to compare hundreds of different travel websites through one meta-search. After the customer finds what service is best for them, they allow them to decide where to book. Kayak mainly services the United States market.

Agoda.com focuses on helping customers reserve hotels throughout Asia. It is the first international company to develop relationships with hotels and display reservation availability on their site. It has grown to become a leader in global travel with offices in more than 30 locations in 28 countries worldwide.

Rentalcars.com focuses on being the global leader in online car rental bookings. Using its site, people can book the best value rental car by comparing cars and reading reviews. The company partners with rental car businesses in thousands of locations in more than 180 countries worldwide.

OpenTable focuses on being the global leader in providing online restaurant reservations. On average, OpenTable seats more than 15 million diners every month across 32,000 restaurants. It seeks to help customers enjoy the best dining experience.

Ctrip (Priceline has $500 million investment in convertible bonds) focuses on travel services for the Chinese Market. Ctrip is known for using rigorous data analysis in making managerial decisions.

Financial Analysis

Competitor Analysis

	PCLN	EXPE	OWW	SABR	Industry
Market Cap:	62.31B	12.51B	1.30B	6.18B	420.49M
Employees:	12,700	18,210	1,530	8,000	775
Qtrly Rev Growth (yoy):	0.19	0.18	0.12	0.83	0.14
Revenue (ttm):	8.44B	5.76B	932.01M	2.63B	128.72M
Gross Margin (ttm):	0.9	0.8	0.81	0.34	0.36
EBITDA (ttm):	3.29B	752.36M	140.03M	685.59M	14.89M
Operating Margin (ttm):	0.36	0.1	0.09	0.16	0.05
Net Income (ttm):	2.42B	398.10M	17.28M	96.76M	N/A
EPS (ttm):	45.67	2.99	0.15	0.23	0.04
P/E (ttm):	26.27	33.03	77.87	108.75	37.23
PEG (5 yr expected):	1.06	1.55	3	1.91	1.35
P/S (ttm):	7.32	2.18	1.39	2.35	5.09

[1]

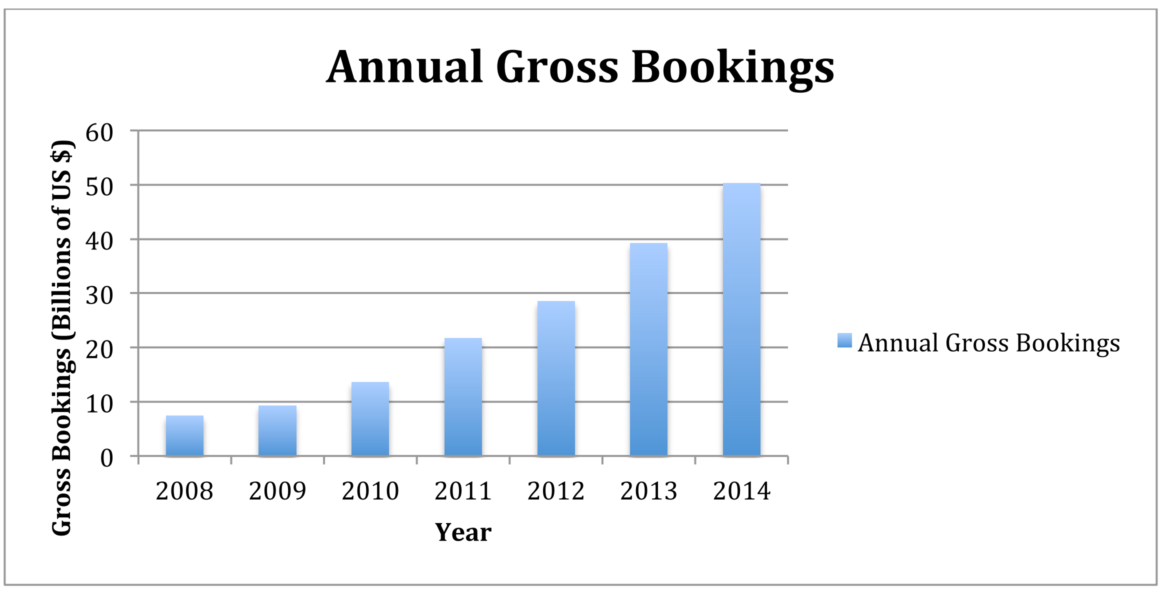
Priceline competes is a very hot space that is growing rapidly, but there are not very many formidable competitors who are able to add as much scale. Priceline has a market capitalization that is five times greater than the next biggest competitor and has revenues that exceed those of the next biggest competitor by more than $2 billion. Economies of scale have proven to be a significant barrier to entry in the industry as the biggest and most efficient companies are able to outcompete the rest. Priceline was able to decrease its cost of sales over a five-year period when the revenues increased more than two-fold. This allows Priceline to have the highest gross margins by a wide divide at 90%. Due to the efficiency of business operations, Priceline is able to have much greater operating margins, and as a result, annual net income is more than six times that of the next biggest competitor. It is notable that although Priceline has significantly greater revenues than Expedia, Priceline is able to operate with close to 30% less employees, enhancing the

[1] Yahoo Finance

operating margins. Regarding valuation, Priceline is the most attractively valued when compared with earnings and even adjusting for expected growth.

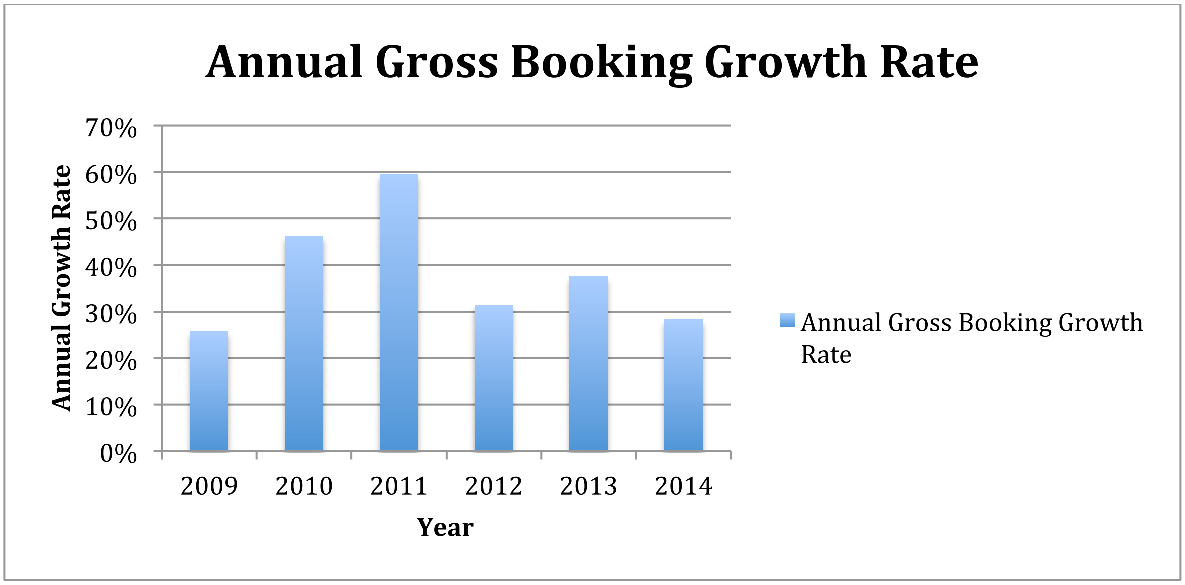
Income Statement

The Priceline Group produces revenue from a few different sources: Agency revenues are the main source of revenue and are derived from travel related transactions where Priceline is not the merchant and where prices are determined by third parties. Merchant revenues are derived from services where Priceline is the merchant and charges the customer's credit card directly. Priceline's Name Your Own Price system is a main contributor to this. Lastly advertising and other revenues are primarily derived from Kayak.com and OpenTable.com.



[2]

[2] http://www.pricelinegroup.com/



It is evident from these charts that the growth in agency revenues can be explained from the growth in annual bookings. Annual gross bookings have been growing very significantly over the past six years, most notably is 2011 with 60% growth from the previous year. Although growth at this level cannot last forever, there is no significant evidence of that it is slowing.

	Year Ended December 31,		
	2014	2013	2012
Agency revenues	$ 5,845,802	$ 4,410,689	$ 3,142,815
Merchant revenues	2,186,054	2,211,474	2,104,752
Advertising and other revenues	410,115	171,143	13,389
Total revenues	8,441,971	6,793,306	5,260,956
Cost of revenues	857,841	1,077,420	1,177,275
Gross profit	7,584,130	5,715,886	4,083,681
Operating expenses:			
Advertising — Online	2,360,221	1,798,645	1,273,637
Advertising — Offline	231,309	127,459	35,492
Sales and marketing	310,910	235,817	195,934
Personnel, including stock-based compensation of $186,425, $140,526 and $71,565, respectively	950,191	698,692	466,828
General and administrative	352,869	252,994	173,171
Information technology	97,498	71,890	43,685
Depreciation and amortization	207,820	117,975	65,141
Total operating expenses	4,510,818	3,303,472	2,253,888
Operating income	3,073,312	2,412,414	1,829,793
Other income (expense):			
Interest income	13,933	4,167	3,860
Interest expense	(88,353)	(83,289)	(62,064)
Foreign currency transactions and other	(9,444)	(36,755)	(9,720)
Total other income (expense)	(83,864)	(115,877)	(67,924)
Earnings before income taxes	2,989,448	2,296,537	1,761,869
Income tax expense	567,695	403,739	337,832
Net income	2,421,753	1,892,798	1,424,037

[3]

Looking at the income statement, it is evident that Priceline has been very profitable over the past five fiscal years. In this period, revenues have come close to doubling from $4.3 billion to $8.4 billion. Additionally, cost of revenues actually declined and net income more than doubled from $1.0 billion to $2.4 billion. Agency and other revenues have been consistently growing over time, while merchant revenues have been flat. Notably however, it has increased its operating expenditures fourfold over the course of five years, a greater pace of growth compared to revenues. This has largely come in the form of advertising and sales & marketing expenditures.

Looking at profitability, Priceline has a profit margin of 28.69%, a gross margin of 89.8%, an operating margin of 36.49, all extremely high relative to the industry standard. In addition, Priceline has an 18.4% ROA, a 30.0% ROE, and a 20.10% ROI, all very high

[3] Priceline Annual Report

relative to the industry. Management has been able to efficiently use Priceline's capital to make a profit. [4]

Balance Sheet

	December 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,148,651	$ 1,289,994
Restricted cash	843	10,476
Short-term investments	1,142,182	5,462,720
Accounts receivable, net of allowance for doubtful accounts of $14,212 and $14,116, respectively	643,894	535,962
Prepaid expenses and other current assets	178,050	107,102
Deferred income taxes	153,754	74,687
Total current assets	5,267,374	7,480,941
Property and equipment, net	198,953	135,053
Intangible assets, net	2,334,761	1,019,985
Goodwill	3,326,474	1,767,912
Long-term investments	3,755,653	—
Other assets	57,348	40,569
Total assets	$ 14,940,563	$ 10,444,460
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 281,480	$ 247,345
Accrued expenses and other current liabilities	600,758	545,342
Deferred merchant bookings	460,558	437,127
Convertible debt	37,195	151,931
Total current liabilities	1,379,991	1,381,745
Deferred income taxes	1,040,260	326,425
Other long-term liabilities	103,533	75,981
Long-term debt	3,849,756	1,742,047
Total liabilities	6,373,540	3,526,198
Commitments and Contingencies (See Note 16)		
Convertible debt	329	8,533
Stockholders' equity:		
Common stock, $0.008 par value, authorized 1,000,000,000 shares, 61,821,097 and 61,265,160 shares issued, respectively	480	476
Treasury stock, 9,888,024 and 9,256,721, respectively	(2,737,585)	(1,987,207)
Additional paid-in capital	4,923,196	4,592,979
Accumulated earnings	6,640,505	4,218,752
Accumulated other comprehensive income (loss)	(259,902)	84,729
Total stockholders' equity	8,566,694	6,909,729
Total liabilities and stockholders' equity	$ 14,940,563	$ 10,444,460

[5]

[4] Yahoo Finance
[5] Priceline Annual Report

Looking at the balance sheet, it is notable that its size grew 43% from the end of fiscal 2013 to 2014. This can partly be attributed to the growth in goodwill associated with the premiums paid for the acquisition of OpenTable in July 2014 and Kayak in May 2013. Additionally, the growth of long-term assets came largely in the form of U.S. corporate debt, U.S. government securities, and Ctrip.com corporate debt and securities. The increase in the amount of assets was largely financed by more than a $2 billion increase in long-term debt and a spike in the amount of net income and retained earnings from the previous year.

Priceline's balance sheet position is strong. Its current ratio is 4.60 and a debt to equity ratio is 0.45, explaining that Priceline has sufficient short-term capital to finance operations and sufficiently low debt. Priceline did however more than doubles its long-term debt over the past fiscal year to close to $4 billion. This should not be an issue though given that Priceline has close to $3 billion dollars in operating cash flow and has an EBIT that is 35x greater than annualized interest expense. Priceline has room to finance operations through debt further without having to worry about remaining solvent.

Statement of Cash Flows

	Year Ended December 31,		
	2014	2013	2012
OPERATING ACTIVITIES:			
Net income	$ 2,421,753	$ 1,892,798	$ 1,424,037
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	78,241	48,365	32,818
Amortization	129,579	69,610	32,323
Provision for uncollectible accounts, net	22,990	16,451	16,094
Deferred income tax expense (benefit)	31,707	(11,104)	19,596
Stock-based compensation expense and other stock based payments	189,292	142,098	72,035
Amortization of debt issuance costs	5,229	7,898	5,212
Amortization of debt discount	54,731	55,718	39,820
Loss on early extinguishment of debt	6,270	26,661	—
Changes in assets and liabilities:			
Accounts receivable	(182,209)	(111,572)	(105,277)
Prepaid expenses and other current assets	(48,932)	(6,909)	(40,793)
Accounts payable, accrued expenses and other current liabilities	203,870	182,163	256,021
Other	1,876	(10,741)	33,864
Net cash provided by operating activities	2,914,397	2,301,436	1,785,750
INVESTING ACTIVITIES:			
Purchase of investments	(10,552,214)	(9,955,800)	(6,352,495)
Proceeds from sale of investments	10,902,500	8,291,283	4,799,412
Additions to property and equipment	(131,504)	(84,445)	(55,158)
Acquisitions and other equity investments, net of cash acquired	(2,496,366)	(331,918)	(33,861)
Proceeds from foreign currency contracts	14,354	3,266	86,159
Payments on foreign currency contracts	(94,661)	(81,870)	(4,014)
Change in restricted cash	9,347	(2,783)	(2,756)
Net cash used in investing activities	(2,348,544)	(2,162,267)	(1,562,713)
FINANCING ACTIVITIES:			
Proceeds from revolving credit facility	995,000	—	—
Payments related to revolving credit facility	(995,000)	—	—
Proceeds from the issuance of long-term debt	2,282,217	980,000	1,000,000
Payment of debt issuance costs	(17,464)	(1,018)	(20,916)
Payments related to conversion of senior notes	(125,136)	(414,569)	(1)
Repurchase of common stock	(750,378)	(883,515)	(257,021)
Payments to purchase subsidiary shares from noncontrolling interests	—	(192,530)	(61,079)
Payments of stock issuance costs	—	(1,191)	—
Proceeds from exercise of stock options	16,389	91,607	2,683
Proceeds from the termination of conversion spread hedges	—	19	—
Excess tax benefit from stock-based compensation	23,366	17,686	5,189
Net cash provided by (used in) financing activities	1,428,994	(403,511)	668,855
Effect of exchange rate changes on cash and cash equivalents	(136,190)	17,987	11,621
Net increase (decrease) in cash and cash equivalents	1,858,657	(246,355)	903,513
Cash and cash equivalents, beginning of period	1,289,994	1,536,349	632,836
Cash and cash equivalents, end of period	$ 3,148,651	$ 1,289,994	$ 1,536,349

[6]

Looking at the statement of cash flows, it is evident that there is a healthy increase in cash flow from a negative to positive value from fiscal 2013 to 2014. In 2013, it should

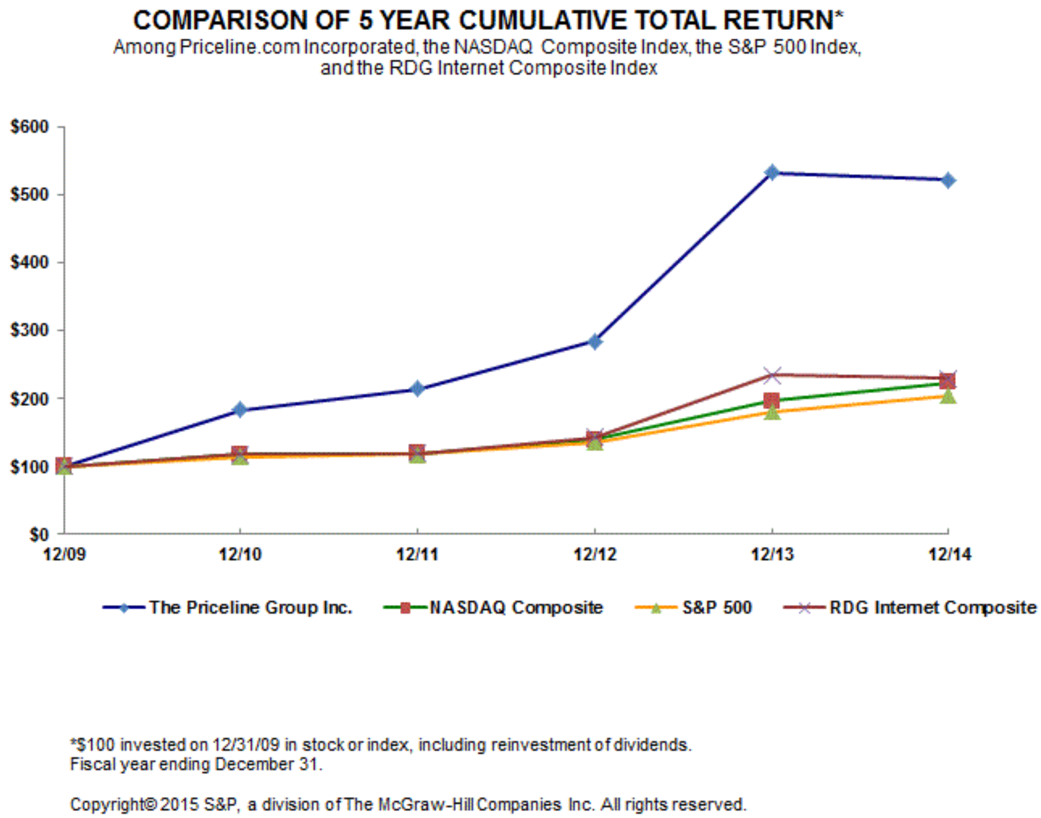
[6] Priceline Annual Report

be noted that there was a negative cash flow of $246 million largely caused by negative cash flow from financing. In this year, Priceline repurchased a significant amount of stock, and a significant amount of senior notes came due. The main differences in 2014 were that net income was close to $600 million greater and proceeds from the issuance of long-term debt were $1.3 billion greater than in 2013. As net income and retained earnings continue to grow for the business, cash flow should continue to follow. However, it is not reasonable to assume cash flow from financing will continue to grow at the pace it did in 2014. As long-term notes become due for Priceline, the cash outflow will eventually begin. Overall however, the statement of cash flow shows that Priceline is healthy and performing well.

Stock Valuation/Performance

Priceline is valued at 23.52 times its current earnings and 17.12 times its forward earnings. Additionally, it is valued at 7.32 times its book value. The valuation appears to be relatively fair since the slightly high P/E multiples could be justified by significant earnings expectations. PEG is a measure that normalizes the P/E ratio for growth and Priceline has a PEG of 1.05, a relatively undervaluation. Additionally, the high P/B can be justified by a high ROE metric. Since the net income that is not distributed as dividends goes back into the book value, a high ROE justifies a high P/B. More importantly, the assets on the balance sheet do not accurately reflect all of the resources that Priceline has. The brand name, customer loyalty, and the network of customers that Priceline has are some of its most valuable assets, but they do not show up on the balance sheet. Therefore it makes sense that the market values Priceline much greater than the book value (assets (understated) – liabilities (more accurately represented)).

When comparing Priceline's valuation to Expedia and Orbitz, Priceline's largest competitors, Priceline looks cheap. Despite having lower growth expectations, lower margins, and smaller ROA/ROE figures, Expedia and Orbitz have forward P/E measures of 20.58 and 24.96 respectively, higher than that of Priceline.



[7]

Over the past five years, Priceline's stock performance has been exceptional, outpacing all competitors in the industry and the market as a whole. However year to date, Priceline's stock has increased very modestly and has increased even more modestly year over year. There has been significant volatility with the stock with the recent changes in the online travel industry and also the uncertainties with the global macroeconomic circumstances. Also, Priceline is an inherently volatile stock since travel is often a luxury

[7] Priceline Annual Report

good for many travelers and it has a beta of 1.83. When global economies are doing well, Priceline does very well, and when global economies struggle, Priceline struggles significantly. Priceline is very dependent on a strong global economy and prices reflect uncertainties more than other stocks might. In addition, Priceline has beat analyst earnings expectations over the past several quarters. Many analysts believe Priceline sets very conservative forecasts and beat their projections as a result.

Conclusion

Financially, Priceline is performing very well. It has grown its top and bottom lines extremely rapidly over the past five years of business. It has by far the strongest margins in the industry and manages its capital efficiently. In addition to this, the business has sufficient capital and liquidity to remain in business in the short and medium term. The stock has performed well in the past several years, but has been near flat over the past year. Currently, the valuation of the business looks relatively attractive compared to competitors in the industry.

Competitive Analysis

Internal Rivalry	Low
Bargaining power of customers	Low
Bargaining power of suppliers	Low
Threat of new entrants	Low
Threat of substitutes	Moderate

Intensity of Competitive Rivalry

The intensity of competitive rivalry is low.

Online advertising expense has grown rapidly for the Priceline group so as to increase brand awareness and drive traffic to the site. The rate of growth for advertising expense has outpaced the growth of gross profit over the past few years. Advertising remains and will continue to be a vital part in the success of the business in driving traffic to Priceline's sites and its strategy must continue to use advertising expenses efficiently.

Priceline's strategy is to continue to participate broadly in the online travel market by expanding services and markets. Priceline plans to by providing consumers with the best experience through relentless execution and constant innovation, partnering with travel service providers to our mutual benefit, operating entrepreneurial, independent brands that share best practices, and investing in profitable and sustainable growth. This strategy has proven to provide Priceline with a leading competitive advantage in the industry, and it has been able to outcompete others through strong brands.

The amount of price competition that Priceline faces from competitors is low. The travel agency industry had combined bookings of $278 billion in 2014.[8] The vast majority of those bookings came from retail agencies, but these retail outlets are not able to compete with Priceline on a cost basis since an online, scaled platform is much more cost efficient. In addition to this, the online travel service industry had four main competitors, but through acquisitions, there are only two big names that compose close to 95% of the online bookings, Priceline and Expedia.[9] However, since the services are relatively undifferentiated and consumer demand is relatively elastic, price competition is enhanced between the two.

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[8] http://www.economist.com/news/business/21604598-market-booking-travel-online-rapidly-consolidating-sun-sea-and-surfing

[9] http://www.forbes.com/sites/greatspeculations/2014/04/08/competitive-landscape-of-the-u-s-online-travel-market-is-transforming/

Buyer Power

The bargaining power of customers is low.

Priceline has the advantage of being the dominant player in the sector with the largest market cap and tremendous scale that is unmatched by rivals. Priceline has a market capitalization of $61 billion whereas the second largest player in the industry Expedia has a market capitalization of $12 billion. Given that there are few big online service providers with efficient operations and scale in the market, consumers do not have the ability to shop around for different online service providers. Therefore, consumers often have to accept the prices that Priceline lists unless they want to sacrifice product, quality, and/or service by booking elsewhere.

In addition, the reservations that are offered on Priceline sites are generally the same price or lower than the prices listed on the actual service provider's site. In fact, the actual service providers generally set the prices that the bookings will be listed at on Priceline's sites. Because of this the buyer has no leverage in forcing down prices. Though even if the suppliers did not set the prices, buyers would still have a low amount of leverage, because with Priceline's scale, it has the ability to be the cost leader and more than likely would be the cost leader when compared to other accommodation sites.

Supplier Power

The bargaining power of suppliers is low.

In the online travel service sector, the suppliers to the sites are the businesses that post accommodations for Priceline's customers to purchase. Since Priceline is by far the leader in the online industry with the most active users on its site, the suppliers rely on

Priceline's brands to sell their excess capacity. Without these brands, suppliers would surely have much more excess capacity than they would without them. Therefore, Priceline has significant leverage when determining what spread they will make on the sale of each accommodation.

Although Priceline relies on suppliers to post accommodations on its sites, suppliers suffer much more without a partnership. Without firms agreeing to list on the Priceline's sites, Priceline also would forgo revenue. Further, if some companies decide not to list, then the quality of the service that Priceline can offer to customers is inherently lower than it could be. But since the supplier market is flooded with different businesses to supply Priceline's sites, competition is very strong. Priceline can afford not to partner with a particular supplier, but that same provider might suffer tremendously if its vacant accommodation is not advertised with Priceline.

Threat of new entrants

The threat of new entry to the online market is low.

It is notable that the industry profitability is high and growing. Once an online business has established itself, the costs associated with running a business are small since there is no significant need to spend on capital expenditures. The number of consumers has grown very significantly with 15.1 million consumers in 1999 to 70 million in 2011. Profits booked are well over $100 billion per year according to analytics firm Jupiter Research. Greater than 38% of travel related purchases are done online rather than through a traditional agent.[10] In addition, margins are growing steadily in the industry.

[10] http://www.wwwmetrics.com/travel.htm

There is significant scale associated with receiving market share in the industry. To enter into the online travel services industry, companies need not spend a significant amount of money on capital expenditure. However, in order to compete with established companies like The Priceline Group, companies must spend significant amounts of money in advertising and brand development. The Priceline Group's six core businesses have established brand names and consumer loyalty over time. In order for a new company to steal market share, it must be willing to win customers over time by spending a significant amount of resources developing an image that consumers can trust.

In addition to scale, Priceline has a network of loyal and happy customers that cannot easily be attracted away. Since Priceline has first-mover advantage and was able to develop a brand name and a network of clients before others in the industry, they have a huge competitive advantage, especially over new entrants. Because of this, there are huge barriers to entry in the industry, and it is unlikely that new entrants would be able to compete well with Priceline and Expedia.

Furthermore, the products in the online travel services industry are mostly non-differentiable, making it difficult for new entrants to stand out to customers. The only way companies try to differentiate themselves is by pricing and packaging the products just slightly different than competitors. For instance, someone who is looking to purchase plane and hotel reservations can shop across different travel service sites and find comparable services. However, Priceline.com offers the Name Your Own Price tool, which is unique to that specific site. Also, Kayak.com tells people their prediction of when the best time to buy tickets are through an algorithm that predicts if prices will be higher or lower in the future. And since The Priceline Group operates under six different brands, they are able to cross sell and package products better to customers than any other online travel service agency.

Threat of substitutes

The overall threat of the buyer to substitute away from online travel services to a traditional form of travel services is moderate.

Some people might decide to switch service providers away from Priceline's brands because the industry makes it very easy to do so. First, bookings on online travel service sites are essentially non-differentiable, and sometimes competitors can offer better deals. And since a hotel room may be listed for the same price on two different travel sites, there would be no reason to choose one online service provider over another. Also, there is no friction to switch service providers, as the user simply needs to change URL's and nothing more.

Despite this, the bookings listed on Priceline's brand's sites are generally priced the same or lower as the prices listed on the supplier and competitor's sites. Again, given that the actual bookings are essentially non-differentiable and other sites do not offer better deals, there is no reason a customer who is satisfied with his or her service with Priceline would switch online travel services. Because of the reliability that Priceline's brands have developed and the network they have built, customers generally habitually choose Priceline's brands rather than switch.

Additionally, there has been a trend toward consumers booking travel reservations online for the past two decades and there are no signs that consumers are likely to switch to using brick and mortar travel service agencies. It is convenient to shop online and easy to navigate, and therefore it is likely that consumers will continue to feel more comfortable booking online and substitute to using Priceline. Therefore, the overall pie to be shared amongst online travel companies appears to be growing without significant threat.

SWOT Analysis

Strengths • **Expansion** • **Profitability** • **Brand name** • **Growth** • **Network** • Efficiency • Management • International presence • Customer loyalty • Scale • First-mover advantage	**Weaknesses** • **Declines or disruptions in the travel industry** • **Dependent on providers of accommodations, rental cars and airline tickets.** • **US Market** • Stock price is highly volatile
Opportunities • **Online advertising** • **Investing in profitable and sustainable growth** • **Changing structure in travel industry** • Emerging markets • Recent Acquisitions	**Threats** • **Intense competition could reduce market share and harm our financial performance.** • **Recent acquisition of KAYAK** • **Increased competition from Expedia** • Poor macroeconomic performance • Social Media competition

Strengths

Expansion

Priceline has a strong user-base in international markets, and it has set the seeds to continue to grow significantly. Priceline has invested heavily in future markets, illustrated by its acquisition of a stake in Ctrip and Agoda.com in order to move into Chinese markets, its heavy spending on advertising, and its purchase of OpenTable. As more and more individuals move into the middle class in emerging markets like China, Russia, India, and Brazil to name a few, the travel market is positioned to grow, and Priceline, more than any other company, is poised to capture market share.

Profitability

Priceline is able to operate in a very profitable way relative to competitors. High margins, including a gross margin of 88.90%, an operating margin of 36.00% and a profit margin of 27.40% allow Priceline to produce higher income from sales. It is notable that the next best competitor has an operating margin of 36%. Priceline is able to operate with only 12,700 employees worldwide, while Expedia employs 18,210 despite having several billion dollars less in annual revenue. Priceline is able to this because of the massive economies of scale they have reached over time. Additionally, Priceline's income yields a high return on equity and return on assets compared to the industry average, 30.90% and 19.60% respectively.[11]

Brand Name

Priceline's brand name is a huge competitive advantage for the business. Through advertising, Priceline has invested significantly to promote its brands and capture user base that has remained loyal to its six brands. This marketing strategy has allowed users to understand the business model and it has helped develop a positive reputation for the firm.

[11] Yahoo Finance

Growth

Priceline has grown its business very significantly in the past several years. From 2009 - 2014, revenues have grown from $2.3 Billion to $8.4 Billion while the cost of revenues has declined. Consequently, net income over this period has grown from $500 million to $2.4 billion. This growth level has significantly outpaced the average growth of the S&P 500 and Priceline's competitors in the space.

Network

Priceline has a vast network of users, which is arguably the most valuable asset it has. Because they were able to enter the industry first and establish a reliable brand name, the network of customers that have used Priceline have become loyal and many are reluctant to switch online agencies. This network is also the biggest barrier to entry, and many firms are unwilling to enter the industry knowing that Priceline has secured a significant portion of the market share and it is extremely difficult to jump that hurdle.

Weaknesses

Declines or disruptions in the travel industry

Financial prospects are significantly dependent upon the sale of travel services, particularly leisure travel. Sales of travel services tend to decline during general economic downturns and recessions when consumers engage in less discretionary spending, are concerned about unemployment or inflation, have reduced access to credit or experience other concerns or effects that reduce their ability or willingness to travel. Because many consider travel a luxury good, when there is an economic downturn, Priceline's top and bottom lines will be hurt more severely than the average company in the market.

Dependency on providers of accommodations, rental cars and airline tickets

Priceline relies on providers of accommodations, rental cars, and airline tickets to make their services available to consumers through us. Arrangements with travel service providers generally do not require them to make available any specific quantity of accommodation reservations, rental cars or airline tickets, or to make accommodation reservations, rental cars or airline tickets available in any geographic area, for any particular route or at any particular price.

US Market

Despite being headquartered in the United States and being the biggest travel service agency in the world, Priceline lags behind in the US market. Expedia controls the US market with a 40% market share, while Priceline has a much smaller 16%[12]. Priceline's US brands, Priceline.com and Kayak.com, are strong, but they have failed to compete very strongly with Expedia. There is work that could be done to enhance brand awareness and user experience for Priceline's US brands.

Opportunities

Online advertising

There are various channels to enhance brand awareness and to generate a significant amount of traffic to Priceline websites. By executing successful advertising campaigns, Priceline's brands can grow and capture additional market share.

12 http://www.stockrover.com/blog-priceline-vs-expedia.html

Investing in profitable and sustainable growth

Priceline can grow in many different ways including strategic acquisitions, partnerships, joint ventures or investments, expanding into complementary business areas, expanding current businesses, and acquiring innovative technology. For example in 2010 Priceline entered the worldwide online rental car reservation market when they acquired TravelJigsaw (now known as rentalcars.com). In 2013 Priceline entered the meta-search business when they acquired KAYAK.

Changing structure in travel industry

There has been considerable consolidation in the travel industry with mergers and acquisitions. The dynamic in the industry is changing and there is opportunity to gain market share in the next few years through strategic purchases. Additionally, since Priceline is the leader in an industry with very few players, it has the opportunity to innovate and lead the industry through innovative solutions for its customers.

Threats

Intense competition could reduce Priceline market share and harm their financial performance

Priceline competes with both online and traditional travel reservation services. The market for the travel reservation services Priceline offers is intensely competitive, and current and new competitors can launch new services at a relatively low cost.

Acquisition of KAYAK

If KAYAK is unsuccessful in profitably growing its global online travel brand or it experiences a significant reduction in advertising revenues due to factors such as a loss of continued access to travel services information provided by other OTAs and travel service providers or a reduction in advertising on its websites and mobile apps, Priceline may incur an impairment charge related to this goodwill.

Increased competition from Expedia

Expedia recently purchased Travelocity for $280 million creating a fiercer competitor in the market. This deal increases the user base for Expedia and allows them to scale their business and become a greater competitor in the already competitive online travel service market.

Strategic Recommendations

For the most part Priceline is doing a great job operating its business. It has been rapidly growing many brands and increasing top and bottom line growth at an impressive compounded annual growth rate. Currently, they are getting to a size where it will be tough for them to continue to grow as quickly as they have been, and they are forced to be disciplined and innovate if they wish to do so. In order to satisfy shareholders and meet some of the high expectations shareholders have, there are a few areas of the business Priceline has to be sure to key in on. Below are guidelines Priceline should focus on in order to succeed in the future:

Priceline should focus on expanding in domestic market.

Despite the extraordinary success that Priceline has had over the past several years, there is stillroom to improve the business. There is still plenty room to grow in the travel services industry, which has grown and will likely continue to grow very rapidly in the coming years. Priceline has fallen behind Expedia in the United States market. Priceline receives only 15% of its revenues in this market, whereas more than half of Expedia's revenues come from the US. Further, Priceline has only 16% of the domestic market share compared to Expedia's 40%.[13] This is surely an area of weakness for Priceline since over 60% of the travel revenues worldwide are combined into the US and European market. For Priceline, growth in US segment was 7%, 15% and 13% between 2012 and 2014 compared to 38%, 42%, and 31% for international bookings.[14] Clearly, the focus has been to gain market share internationally, but in order to meet potential, Priceline needs to transfer more energy domestically.

To expand into the domestic market, Priceline needs to continue to develop its domestic brand Priceline.com. In 2013 more than 65% of Priceline's revenues came from its brand Booking.com, which is focused mainly in Europe. In order to enhance the brand value in Priceline.com and increase the share of revenue from this brand, Priceline should both allocate a greater portion of its advertising budget to showcase Priceline.com and enhance the customer experience on the site.

Regarding the advertising, Priceline should increase its advertising budget in the United States and enhance brand value for Priceline.com. However, over the past four fiscal years, selling, general & administrative expenses increased over 160% driven primarily by advertising expense whereas revenues increased less than 100% during the same time. Over time Priceline will be forced to slow down its advertising expense growth so that

[13] http://www.stockrover.com/blog-priceline-vs-expedia.html
[14] http://seekingalpha.com/article/2959326-priceline-the-vacation-continues

operating expenditures do not continue to outpace the sales growth. With this in mind, if Priceline is to increase its expenditure on advertising in the United States, management must be mindful of this and run campaigns that will be particularly effective with high-expected returns.

Regarding enhancing the user experience, there are several aspects of its site that could be improved upon. Here are some ideas to help:

Priceline should offer flexible flights to users like Skyscanner.com. Currently, if one types in a travel date, he does not have the ability to compare and contrast different dates and times to find the cheapest flights, hotels, etc. This feature could turn into a valuable attraction for many users and might persuade some customers to purchase travel reservations from the site when they might otherwise have thought a travel reservation was too expensive.

Priceline should be more flexible with its payment options. Currently, its only payment option is all at once and in advance, making payment for an expensive vacation difficult. Other travel sites allow for payment at the time of staying for a modest fee. Additionally Priceline only allows for payment in native currency (the booker's currency) rather than the currency of the hotel. In general the company seems to be poorly integrated with travel cards and banks.

Priceline should improve its bid system. The bid system that Priceline bases its business model around is not very user friendly to navigate. It could use more emphasis on the main page and a streamlined process to make it more inviting. Without the bid system

Priceline does not have a clear advantage over any other travel site and notable disadvantages in navigability, booking flexibility, and bundling.

Priceline should work to improve its cancellation procedure. Cancelling and making last minute changes to bookings made through Priceline are extremely difficult if not occasionally impossible, making Priceline unattractive for last minute travellers or travellers looking for a flexible experience.

Priceline should focus on investing in developing markets.

In addition to the domestic expansion, the global travel market is changing rapidly, and Priceline needs to seek out opportunities in emerging economies. The domestic market is maturing whereas the growth rates internationally outside of Europe are expanding very rapidly. China's middle class in particular is growing rapidly and their share of the online travel market is expanding. 34% of the online travel market comes from Asia, and this number is expanding. In addition to China, other emerging markets are expanding including India where there is plenty of opportunity available to expand market share.

There has been quite a bit of consolidation in the industry and Priceline should continue to seek strategic opportunities to acquire travel companies abroad. The emerging economies are growing much more rapidly than the domestic one, and setting the seeds to capture markets where there is a lot of potential could be an extremely worthwhile venture. Currently, Priceline has more than $3 billion in cash sitting on its balance sheet. Additionally, Priceline has a debt to equity ratio of 0.45, well below its capacity, and an interest coverage ratio of 35. If Priceline is able to find a strategic acquisition abroad that makes sense, it has more than enough capacity to finance a transaction. By continuing to invest in emerging markets early, Priceline could realize significant returns in the future.

Priceline should better integrate acquisitions and cross sell products.

Besides focusing on key markets, Priceline should also work to better integrate many of the acquisitions that it has made. Rather than just owning many different business-lines and operating them separately, Priceline should be able to better cross sell products to customers. It is in the unique position to have access to several different services that could enrich the customer experience if integrated properly. For instance, a customer may be interested in purchasing flights, hotels, rental cars, and restaurant reservations for a single trip. Priceline owns four different businesses that can guide a customer in all aspects of this. Packaging deals for customers and offering discounts to those who purchase deals in "bulk" could benefit the customer and provide additional business to Priceline.

Specifically, Priceline needs to focus of integrating its newly acquired OpenTable to its business. Priceline acquired OpenTable for $2.6 billion at a 46% premium hoping to be able to adapt its business model to Priceline's strategy. OpenTable operates with a similar idea of helping vacant restaurants to fill their tables. This acquisition seems to make sense, but management needs to take advantage of this opportunity in the upcoming quarters.

Conclusion

Priceline has been performing very well over the past ten years. It has grown its business significantly in terms of its top line and bottom line, and it has shown little signs of slowing down. Priceline competes in a very consolidated online travel service industry, which represents around 40% of the total travel agency industry. It is by far the biggest travel agency in the world and has a huge competitive advantage with scale and network of customers. Looking forward with the business, there are many bright spots to look forward to, but there is much uncertainty that may hinder performance. In order to continue to grow and prosper as it has in the past, Priceline must build upon its business. In particular, Priceline should focus on gaining market share domestically by expanding domestic advertisements and investing in the customer experience, focus on integrating its brands and better cross-selling its products, and focus on investing in developing markets to capture high returns in the future.