RESEARCH REPORT

October 22, 2018

Stock Rating	BUY
Current Price	USD $1,806

Bear Case	Price Target	Bull Case
$2,100	$2,541	$2,786

Ticker	BKNG
Market Cap (MM)	$85,722
EV / EBITDA	15.0x
P / E	20.3x

52 Week Performance

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Booking Holdings Inc.

A Second Look

Booking Holdings operates several Online Travel Agencies (OTAs), including Booking.com, as well as meta-search websites, including KAYAK.

Following the initial Booking Holdings report, *A Travel Industry Leader*, the Consumers & Healthcare team decided to follow-up on some important topics.

Summary

- The Asian market serves as a key growth lever for Booking Holdings.
  - The size, growth trajectory, consumer characteristics, and implications for the original thesis are analyzed.
- Acquisitions have been an important part of the company's past performance.
  - The acquisition of Booking.com in 2005 is sometimes credited as being the most successful internet deal in the history of M&A.
- This is a large market with many capable competitors.
  - The Google threat is briefly revisited, and Expedia and Airbnb are introduced.
- The key to our intrinsic value estimate is the execution of the brand advertising strategy.

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Asian Tourism Market Overview

An important growth lever the QUIC team identified in its initial investment report on BKNG was the appealing market of outbound Asian tourism, particularly to Europe. The purpose of our second look at this thesis is to better understand the market characteristics and resulting implications for BKNG's within the Asian market.

The growth in Asian travel is well understood and is largely priced in to BKNG's current valuation. However, the C&H team believes it is important to discuss this growth lever – understanding the Asian travel market allows QUIC to have conviction in our recent position in BKNG, and establishes a baseline to monitor for underperformance, which may suggest unfavorable competitive developments.

Relative Size

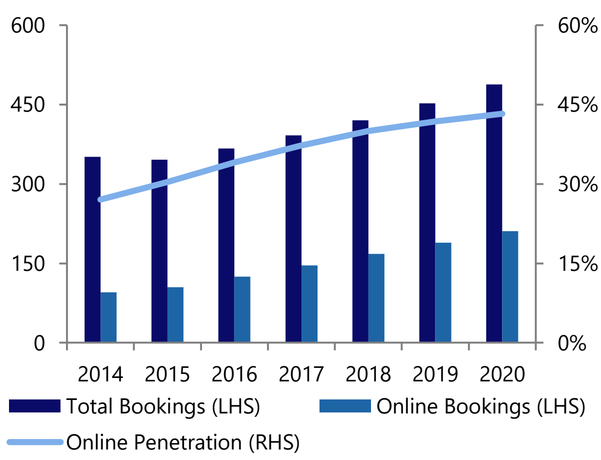
Outbound travel by Chinese tourists ranks first in the world, totaling $260B in 2016. This is a result of rising disposable income, urbanization, relaxed restrictions on foreign travel, and sheer population size. In 2020, APAC total travel bookings are expected to be $488B, outpacing the United States by $70B (Exhibit I).

Growth Trajectory

The growth trajectory for Asian consumer tourism bolsters Booking's prospects, particularly through online channels. Online tourism bookings are grown through (1) total market size growth and (2) growing online & mobile penetration. Given Booking's online platform, they are poised to benefit from both of these secular industry trends. While total travel bookings growth YoY in the APAC region was an estimated 7% in 2017, online-specific growth was 10% higher at 17%. The differential between total and online bookings growth among Asian consumers is expected to remain present for the foreseeable future, albeit at a slightly lower magnitude as online matures. In 2020, online bookings growth is estimated to grow 12% YoY and total bookings growth is expected to be 8% (Exhibit II).

EXHIBIT I

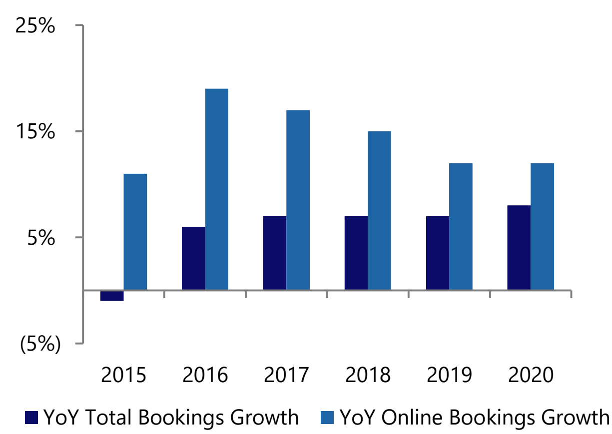
APAC Consumer Travel Spend ($B)



Source(s): Credit Suisse

EXHIBIT II

APAC Online Bookings Growth



Source(s): Credit Suisse

Asian Tourism Market Overview: Consumer Characteristics

Accommodation Spend

A key difference in the buying patterns of Asian consumers in comparison to their western peers is views towards spending on accommodation. Affordability of travel is only the fifth-most important factor to the Chinese, in comparison to the second-most important factor for non-Chinese consumers. However, while non-Chinese consumers spend the most on accommodations while travelling, Chinese consumers spend more on shopping, then followed by accommodations. This difference in spending ideologies is negative for online travel agencies like Booking, as the commission revenue model earns more when the consumer spends more on their accommodations. With that being said, this consumer characteristic is widespread and will not hurt Booking any more than its competitors.

Travel Destinations

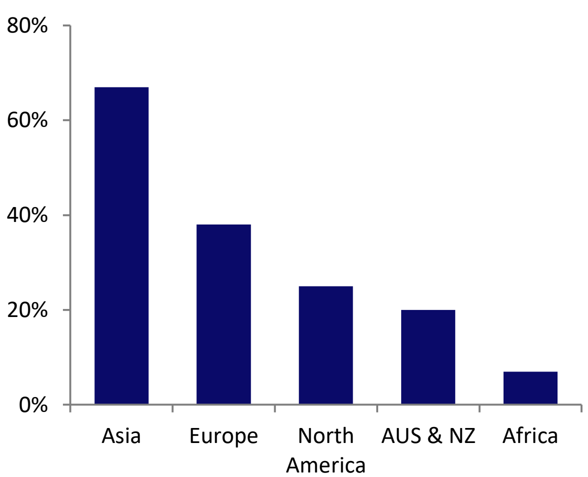
The most popular destination for Asian travelers is within Asia. Neilsen reported that in 2017, 68% of Chinese travelers go to locations within Asia like Japan or Thailand. Europe and North America are the next most popular travel destinations, with 38% and 25% of Chinese travelers having visited Europe and North America, respectively (Exhibit III).

While travel within Asia is currently the majority of Chinese travel, Neilsen expects a destination shift to favor more travel to Europe and North America. According to the European Travel Commission, the number of Chinese households that can afford long-haul travel will triple in five years, from ~20M households at present to 60M households in 2023.

While BKNG's accommodation footprint is spread globally, the company is most dominant in the European and North American accommodation markets. This means that BKNG benefits from the shift of Chinese travelers increasing their frequency of long-haul, inter-continental trips.

EXHIBIT III

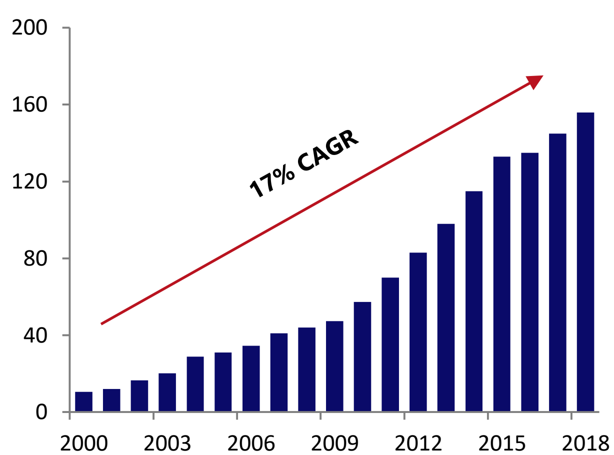
Chinese Leisure Travel: Destinations Visited per Year



Source(s): Credit Suisse

EXHIBIT IV

Chinese Leisure Travel: Long-haul Travelers (MM)



Source(s): The European Travel Commission

Asian Tourism Market Overview: Implications for BKNG

Mobile Booking Tailwinds

China's online travel bookings are more "mobile penetrated" than any other country, despite a lower proportion of online vs traditional bookings compared to competing travel markets. This enables lower customer acquisition cost as clients deal directly rather than referral through search platforms.

In 2015, mobile held ~40% of all online sales in China, and is expected to capture ~75% of online Chinese travel bookings by 2020. To add context, the next most "mobile penetrated" geography is Japan, which will reach ~40% of total online tourism bookings by 2020. This consumer trend plays well into Booking's shift from variable marketing channels, like search engine advertisements, to direct bookings through increased brand advertisement spend. With a greater proportion of bookings made on mobile in China, Booking will be able to capture more sales direct on its app – a more profitable customer acquisition strategy that mitigates competitive risks from search providers entering the booking phase of the process. This was a risk explored in depth in our first look at BKNG.

China's mobile penetration will help BKNG realize the C&H team's thesis surrounding margin expansion from more direct orders and downplay competitive threats from search-oriented players.

The Efficacy of Agoda

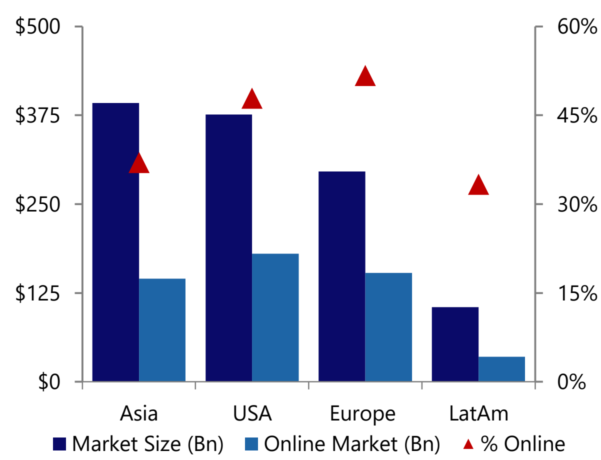
Given that Asian travel growth is well publicized and understood by the market, the ability for BKNG to capture growth hinges on the success of their Agoda brand. While Agoda caters to Asian travelers, it does not have a dominant position within China. Of Agoda's ~2M property listings, Credit Suisse estimates that just 1% of properties listed are located in China. Ctrip, China's leading OTA, has an estimated 46% market share in the online travel market in China, with two state-owned travel agencies as the next largest players. However, the large OTAs in China house primarily domestic travel accommodation inventory. Agoda is a leading OTA in Asian markets like Thailand and Indonesia, and BKNG's inherent strength in increasingly popular Chinese destinations like Europe and North America mean that the Chinese OTA incumbents do not pose a credible barrier to Agoda's success in capitalizing on the growing outbound Chinese travel market.

The lack of Chinese traction is likely not a determining factor in BKNG's ability to realize Asian travel growth given that a large portion of the mentioned growth will be long-haul trips to Europe and North America, where BKNG is the dominant player with the largest accommodation inventory. Further, BKNG holds a 12% stake in Ctrip, providing meaningful exposure to the domestic Chinese travel market. Key rivals (Expedia & TripAdvisor) hold no similar stakes.

A greater understanding of the Asian outbound travel market allows the C&H team to quantify expected growth rates and monitor BKNG's performance against a benchmark as we hold the name.

EXHIBIT V

Global Travel Market: Size and Online Penetration



Source(s): Company Reports, Credit Suisse

Recent Acquisition History

History

Touted as "one of the best deals in the history of the internet" by analysts, Priceline's $135MM acquisition of Booking.com is worth the near-mythical status ascribed to it by the financial industry. Now a primary reason for Booking Holdings' (Booking) dominance in the travel industry, the acquisition of Booking.com has been an unparalleled success. Fueled by this, Booking's management has continued to acquire aggressively. While the return derived from the original Booking.com acquisition is unlikely to be seen again, management has completed many strategic investments which should stimulate the long-term growth of the company. Through successful acquisitions such as agoda.com (2007) and TravelJigsaw (2010, now RentalCars.com), which have stimulated significant growth, Booking has garnered the reputation of being a skillful acquirer. This section of the report will summarize the several transactions that have been conducted under the current CEO, Glenn Fogel and the preceding CEO, Darren Huston, covering the period of 2013-2018. We will discuss the business model of each acquiree and analyze the strategic rationale behind each acquisition. We selected a five-year time frame in order to focus on the recent strategic decisions of management, which should be more predictive of future decisions. The acquisitions that will be highlighted are Kayak, Buuteeq, Hotelscombined, OpenTable, Price Match, Rocketmiles, AS Digital and Momondo.

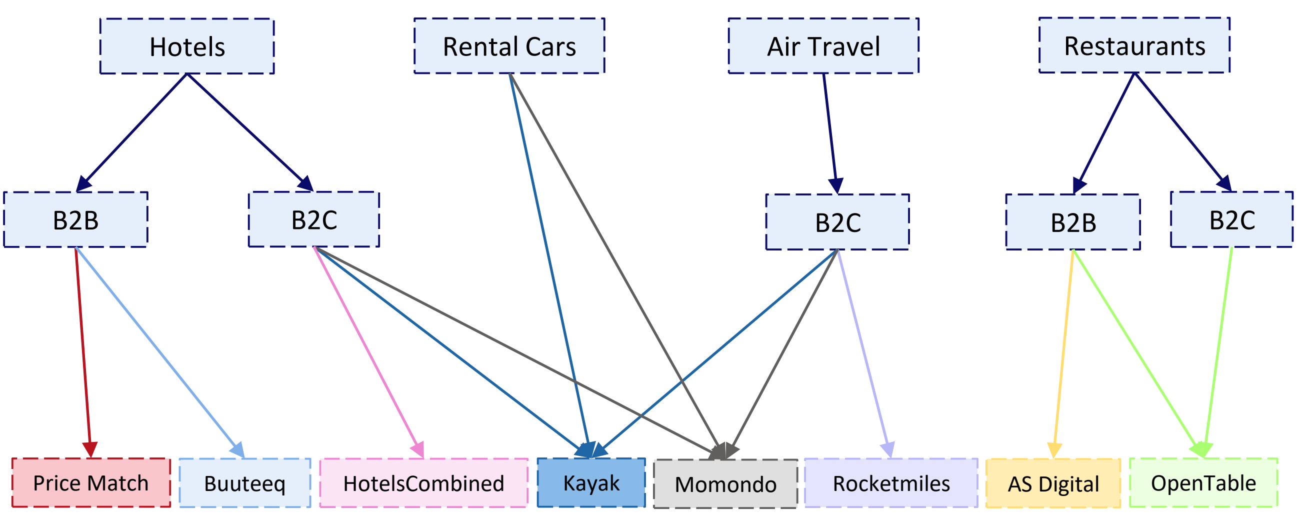
Hotel Acquisitions

The most significant hotel-related acquisitions that have occurred over the past 5 years are those of Buuteeq, Price Match and Hotelscombined.

Firstly, Buuteeq. Buuteeq was acquired in 2014 and operates a business-to-business (B2B) platform which offers cloud-based digital marketing software to hoteliers. The purpose of this software is to help hoteliers develop their brand and promote bookings.

EXHIBIT VI

The Role of Acquisitions (2013-2018YTD)



Source(s): Company Reports

Recent Acquisition History

Price Match, another B2B business, was acquired the following year. Price Match is a cloud based data and analytics company committed to serving the hotel industry. Through proprietary algorithms, PriceMatch delivers data to hotels, giving operators a deeper understanding of their performance. Booking has been developing an assortment of B2B services. Price Match, for example, has been incorporated into the larger B2B service, BookingSuite, which helps hotels market and manage their businesses.

Developing the B2B market has allowed Booking to diversify as well as develop strong partnerships with the operators of boutique hotels. While the degree of crossover between the partnerships developed on the B2B platform and the hotels listed on the business-to-consumer (B2C) platform are unclear, the strengthening of B2B partnerships would likely provide some degree of benefit to the consumer facing side of the business.

Acquired in 2018, Hotelscombined, an Australian-based B2C website, offers consumers the opportunity to compare hotels, primarily on the basis of price. Kayak, one of Booking's primary operating units, offers a similar service. Hotelscombined, however, has a strong presence in the Asian Pacific. Booking may leverage Hotelscombined's regional presence to gain a higher overall market share, as Hotelcombined continues to operate as a separate unit.

Air Travel Acquisitions

Two acquisitions in Air Travel completed over the past few years are those of Rocketmiles and Momondo.

Rocketmiles, acquired in 2015, offers customers who book through its website airmiles on their hotel stays. Although currently operating as an independent unit, analysts view this acquisition as an opportunity to create a more loyal customer base for Booking as a whole. Booking currently has a very weak loyalty program, the incorporation of Rocketmiles' compelling value proposition could provide the stimulus to create a more loyal customer base.

Next, Momondo. Momondo operates in a similar capacity to Kayak, another Booking subsidiary, in that it aggregates flight, hotel and rental car data to provide comparison features for customers (e.g. price comparison). Momondo owns both its eponymous website and Cheapflights, a website completely dedicated to airfare price comparison. While Momondo does offer comparison options for many parts of the travel experience, its primary service relates to air travel. A key difference between Kayak and Momondo is the markets in which they are dominant. Momondo's market is far more concentrated geographically in Europe. As such, the companies look to execute mutually beneficial marketing campaigns by increasing marketing in areas where they have achieved significant traction (i.e. the UK for Cheapflights and Germany for Kayak) and decrease marketing in the other company's dominant market. Apart from the reduction of competition, Booking looks to benefit from its acquisition of Momondo by helping it to expand further internationally. Last, the Momondo acquisition should help Booking to capture the wallets of a younger audience who tend to be more budget conscious than the average Booking user. Momondo has been able to create a loyal customer base within this segment, a feat which Booking has yet to accomplish to the same degree.

Restaurant Acquisitions

Booking has made two acquisitions in the restaurant space in the past five years, OpenTable and AS Digital.

OpenTable, acquired in a 2014, $2.3B transaction, was a significant add-on for Booking. At the time of the acquisition, OpenTable was already the world's leading provider of online restaurant reservations. Aside from the B2C reservation arm of the company, OpenTable also offers marketing and other B2B services direct to restaurateurs. As for the rationale behind the transaction, restaurants play a key role in the average travel experience. Booking's mission to "help people experience the world", would not be complete without a restaurant arm.

Recent Acquisition History

Additionally, Booking cited the opportunity to "accelerate [OpenTable's] global expansion and increase the value offered to restaurant partners" as growth prospects. OpenTable is a primary division within Booking and has expanded vastly, now boasting 43,000 restaurant partnerships and 24M diners/month.

AS Digital, another restaurant acquisition, is committed to the B2B space, providing restaurant table and reservation management solutions. AS Digital has been incorporated into OpenTable to increase the value offered to restaurant partners, as was outlined in the original goals of the OpenTable acquisition.

The Acquisition of Kayak

Kayak, now one of Booking's primary operating units, was acquired in 2013 for a total value of $1.8B. Kayak is a travel research and booking site that gives customers the opportunity to compare travel sites at once when searching for flights, hotels, and rental cars. Booking acquired Kayak with the intention of expanding its global presence. Additionally, Kayak's business model has allowed Booking to compete more directly with other meta-search businesses. Since the acquisition, Booking has successfully expanded Kayak from its limited international presence, 18 countries in FY2012, to its current 60+ country operating base. The platform has serviced 2B customer queries.

Strategic Rationale

Booking boasts a successful history of conducting profitable acquisitions and leveraging each acquirer's unique attributes to expand. Booking's success in this facet of business can be attributed to strategic discipline and foresight, which have allowed the company to retain its relevance in an everchanging industry. Using a collection of recent acquisitions we have been able to back into the company's strategic priorities in acquisitions. By evaluating the priorities derived from these acquisitions, we assessed each priority's potential and therefore whether Booking's success in leveraging acquisitions will be carried forward into, at least, the near future.

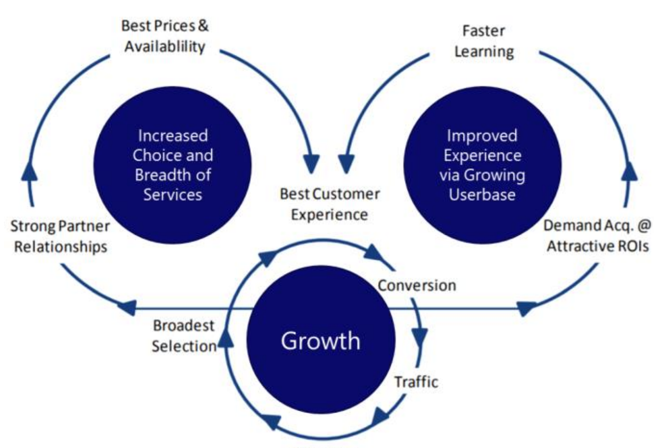
Overall the primary three priorities which we have been able to deduce from Bookings' acquisitions over the past five years include: improving the value of their services to their business partners, accessing new markets, and achieving overall dominance in all parts of the online travel experience.

By leveraging synergies and respective core competencies of acquisition targets, Booking is able to improve the value of their own services. For example, leveraging Kayak's technology and brand name has improved the user experience for its other products. Similarly, each acquisition represents different geographic and industry based markets that expands Booking's market presence. Finally, extensive market presence and synergistic acquisitions help contribute to overall dominance in the entire travel booking process as Booking is able to own the journey from inspire to search to compare to purchase and share.

These three aspects contribute to the two key drivers of the company's growth drivers: increased choice and breadth of services and improved experience via a growing userbase. Both spearhead customer growth.

EXHIBIT VII

Strategic Company Growth Cycle



Source(s): Company Investor Presentations

Competition

As identified in QUIC's initial Booking Holdings report, the company has 2 strong competitive advantages and an emerging third (network effects, economies of scale, and brand power, respectively). However, this is a large market with many capable competitors which must be considered.

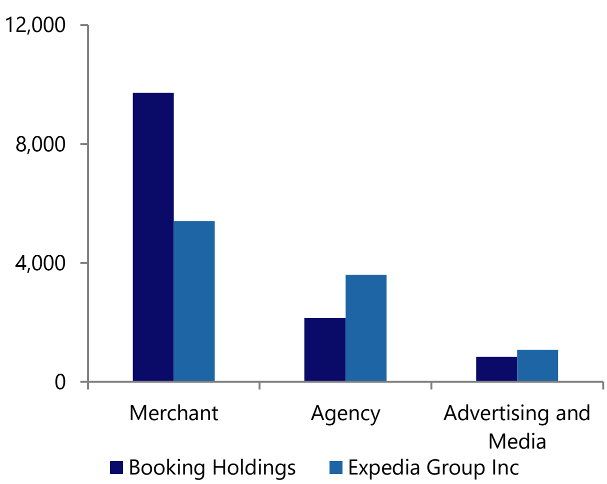
Expedia Group Inc

Expedia, Inc. is an online travel company, empowering business and leisure travellers through technology with the tools and information they need to efficiently research, plan, book and experience travel.

The company's largest revenue stream is from hotel reservations with 70% of its revenue coming from hoteliers. The company has seen this grow 12% over the LTM. The key drivers of the growth have been the acquisition of smaller reservation sites to add to its increasing repertoire of websites (over 135 in various languages under 12 different brands).

EXHIBIT VIII

Revenue Comparison by Business Model ($USD M)



Source(s): Company Reports

In contrast, agency revenue is the largest portion of Booking Holdings revenue with 77% of their total revenue coming from the service. The company plans on increasing this segment of the business by focusing on brand marketing. In the beginning, this strategy may compress margins, however, it is a wise strategy to secure growth in the long term and avoid increased risk from depending on referrals from intermediaries that could become e competitors in the future, such as Google.

Airbnb and the Alternative Accommodation Market

Airbnb is a privately-owned OTA which focuses on "alternative accommodations." Alternative accommodations, which largely consist of homes, are only a small part of the overall accommodations industry. However, Booking Holdings is becoming increasingly more exposed to this market.

This business is generally less profitable than Booking Holdings' traditional hotel business. This is because acquiring 1 hotel property results in ~55 listings on Booking.com, while the alternative properties only result in ~4 listings. In general, alternative accommodation suppliers require more support at a higher cost, though Booking Holdings plans to make the process more efficient over time through the use of technology. While less profitable, Booking Holdings still believes the growth opportunity and competition from Airbnb is worthwhile.

In the media, Airbnb is portrayed as the clear leader of the alternative accommodation market. As of Q4 2017, Booking Holdings began to report property count and listings data surrounding its alternative accommodations business. At 1.5M properties and 5.5M listings, it may surprise travellers to hear that Booking.com is practically tied with Airbnb's network. While these stats reflect supply, it is estimated that Airbnb converts more of these listings to actual bookings than Booking.com.

Competition (Cont.)

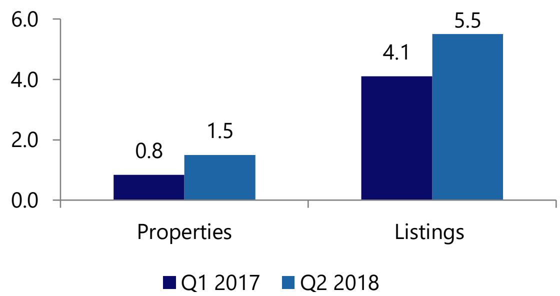
As a result, Booking Holdings has vocalized its frustration with their customer's unawareness of their alternative selection. The company expects to advertise this business more heavily, and has begun featuring their alternative accommodations on the same search pages as their traditional hotels.

Booking Holdings understands that property supply is only part of the equation for success. Marketing is another key aspect, one which Booking Holdings has consistently excelled at. Given the far greater traffic and scale of Booking Holdings, it is not unimaginable that Booking Holdings may earn a higher share of this market than Airbnb. In other words, if Airbnb remains solely focused on the alternative accommodations market, its service will not be able to expose its properties to as much traffic as Booking.com.

Both companies are also trying to gain a larger share of their customers wallet by implementing on-location experience bookings. Users of Airbnb are already familiar with this feature and have responded positively; Booking Holdings has been acquiring businesses in this space as they attempt to growth their value proposition and become a one-stop-shop for all their customer's travel bookings – not just their accommodation. Booking.com's integration with Rentalcars.com and Priceline.com sets them up well to execute.

EXHIBIT IX

Booking.com Reported Alternative Accommodations



Source(s): Company Reports

For now, competition risk from Airbnb is relatively insignificant for QUIC's investment

Google

The initial Booking Holdings report dove into the Google threat, and how Google might shift from a trusted partner to a capable competitor.

Booking Holdings refers to Google as a great partner; it is rumored that the company is the single largest customer of Google's advertising business.

As Google continues to build out its Google Flights and Google Hotels meta-search business, it is directly competing with Booking Holdings' KAYAK and Momondo meta-search business. While this is a real threat, we emphasize that these businesses only represent ~7.5% of Booking Holdings' total gross profit. In fact, Google's meta-search business redirects customers to OTA's such as Booking.com.

The company acknowledges Google's ability to move more heavily into actual bookings, but we believe this is not Google's expertise, which is search and advertisements. It takes a long time to build a wide selection of bookable properties, and while Google does already have the customer part of the network effects, we believe the company's ability to compete with Booking Holdings on the supply side is limited to the extended future.

Booking Holdings has taken on a strict strategy to deal with smaller meta-search partners which are trying to compete directly with Booking.com. Put simply, if these partners use Booking Holdings' advertising expenditure to fund their own booking business, Booking Holdings will no longer/reduce their advertisements with said partners. While this may result in lower short-term growth, this strategy solidifies Booking Holdings' long-term position in the market. Furthermore, as the direct channel grows as a percentage of total traffic, Booking Holdings will be even less exposed to this competitive risk.

Valuation Risk

We value BKNG at $2,540.62 per share. We attribute the majority of the upside over the traded price to the execution of the company's new advertising strategy. As Booking Holdings moves to brand advertising to drive more direct traffic instead of performance advertising, the business becomes more profitable. Although performance advertising spend will still grow, we expect it to do so at a slower rate than gross profit growth. In this scenario, EBITDA margins could expand from ~39% to ~45% over time.

In the downside scenario, Booking Holdings' brand advertising fails to gain traction and the company must continue to spend on performance advertising at a faster rate. If the strategy fails and declining ROI's on performance advertising persist, BKNG shares may only be worth ~$2,100. Even at this downside valuation, BKNG shares are worth 16% more than the traded price.

We implicitly value Booking Holdings' ability to shift away from performance advertising at ~$440 per share.

EXHIBIT X

Brand Advertising Execution Risk

% of Gross Profit	2017	Forecast	Downside
Performance Advertising	33.3%	26.5%	35.0%
Brand Advertising	3.2%	7.0%	7.0%
EBITDA	39.4%	44.5%	36.0%

	Traded Price	Valuation	Downside
Share Price	$1,805.74	$2,540.62	$2,099.79
Total Return		40.7%	16.3%

Source(s): Company Reports, QUIC Estimates

References

1. Company Reports
2. Credit Suisse
3. The Economist
4. The European Travel Commission