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BOOKING HOLDINGS

Nasdaq:BKNG

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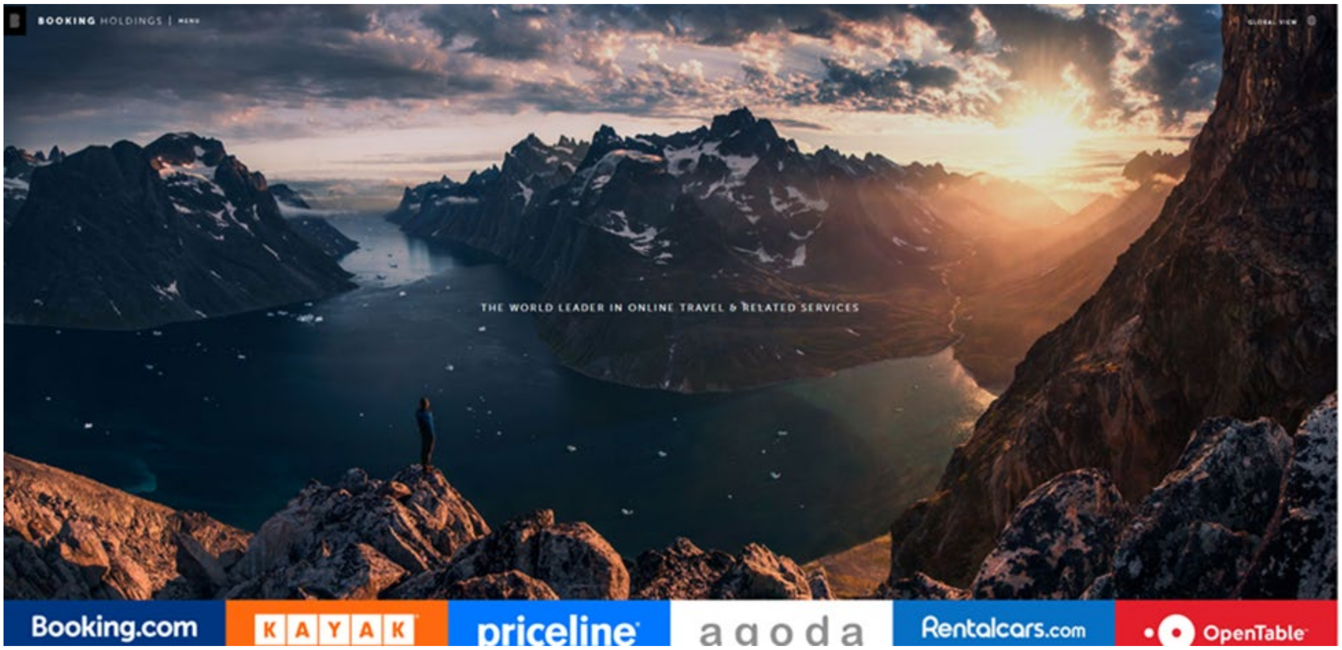
Note: All dollar figures are $US unless stated otherwise.



Investment Thesis

Booking Holdings Inc. (Nasdaq:BKNG) is the world's largest online travel agency (OTA). The online travel industry is likely to benefit from two long-term secular tailwinds: rising incomes and the shift to online booking. We believe that the Company's leading competitive position will remain intact due to a network effect and other moats.

Conservative Q1 2019 guidance and short-term macroeconomic concerns have caused the stock to sell off to attractive levels. At the current stock price of $1,844, the stock is trading at a below-market multiple for an above-average company in terms of quality and future growth prospects.

Organic growth combined with significant share repurchases should result in intrinsic value compounding at double-digit rates for years to come.

Disclosure: The GreensKeeper Value Fund and accounts managed by GreensKeeper Asset Management Inc. currently own shares of Booking Holdings and certain other securities mentioned in this report.

Introduction

Booking Holdings Inc. ("Booking Holdings" or the "Company") is the largest online travel agency (OTA) in the world by hotel rooms booked and revenue. The Company was formerly known as Priceline Group and renamed in 2018 to better reflect its dominant brand and its growing booking platforms in new market verticals.

The Company operates in more than 220 countries and territories through six primary brands: Booking.com, KAYAK, Priceline, Agoda, Rentalcars.com and OpenTable. Collectively, Booking Holdings operates in more than 40 languages across Europe, North America, South America, the Asia-Pacific region, the Middle East and Africa. The Company is headquartered in the United States, but generates 89% of its revenues internationally with Europe being its largest market.

We acquired our initial position in Booking Holdings in Q4 2017. In February 2019 the Company reported its 2018 year-end results that beat both their guidance and consensus. However, the Company's Q1 2019 guidance was lower than expected due to slowing bookings in Europe—by far its largest market—caused by a slowing economy and Brexit. With the stock selling off over 10% we updated our models and increased our position.

Business Model and History

Substantially all (93%) of the Company's revenues are fees earned from travel reservations for accommodations, car rentals and airline tickets. The balance of revenues (7%) are from advertising and referral fees from the Company's Kayak travel metasearch website, restaurant reservation fees from the OpenTable platform and commissions from attractions bookings.

Within travel reservations, we believe that accommodation bookings are by far the most significant revenue category. Rental car days and airline tickets booked represent only 10% and 1% respectively of room nights booked and are lower margin than hotel bookings. Given the financial dominance of the accommodations booking business, this report focuses almost exclusively on that segment.

Accommodations bookings are conducted via two different models: agency and merchant models. Under the agency model pioneered by the Company in Europe, travelers book accommodations and pay the hotel/host directly upon arrival. Like traditional travel agents, Booking Holdings earns a commission which is billed to the service provider once the travel stay is completed. Under the merchant model, an OTA purchases rooms, airfare, etc. in bulk from suppliers, marks them up and then resells them to travelers, typically as vacation packages. In 2018, agency bookings represented 78% of the Company's bookings with merchant bookings the remaining 22%. The Company uses both models depending on the geographic market and consumer preference.

Booking Holdings benefits travelers by providing useful information on millions of instantly bookable accommodation options, real-time comparison pricing and traveler reviews. Its vast offering and customer service infrastructure provide travelers with value at no additional cost to the consumer.

Booking Holdings' commission rate on agency bookings—known as the "take rate"—fluctuate from quarter to quarter but averaged 14.2% in 2018 which was a modest increase over prior years (2017–13.9%, 2016–13.6%).

Certain hotels have complained about the high commissions charged by OTAs, but ultimately choose to continue to participate on the OTA platforms as the referrals received increase occupancy rates. Hotels operate largely fixed-cost businesses and higher occupancy significantly improves profitability. The incremental revenue from filling an empty room adds almost no cost to the room supplier.

Booking Holdings is particularly strong in Europe where its Amsterdam-based Booking.com brand began whereas number-two competitor Expedia Group's roots are in the United States. The European hotel industry has a much higher percentage of independent/boutique hotels than the United States (65% in Europe vs. only 30% in the United States according to Morningstar).

Small hotels are generally less well staffed, less sophisticated and have smaller marketing budgets than the larger chains. This combination of factors makes smaller hotels more reliant on travel agents including OTAs to advertise their offerings and attract customers. Many larger chains (e.g. Hilton, Marriott) use OTAs but also market directly to travelers via advertising, promotions and loyalty programs. Their size also gives them the ability to negotiation lower commission rates with OTAs.

Booking.com was a pioneer in offering the agency model to European travelers which they generally prefer as it allows them to pay at the time of the stay (versus prepaying under the merchant model). This innovation attracted European hotels to the platform which attracted even more travelers. The reinforcing feedback loop of this network effect over many years and the Company's first-mover advantage allowed Booking Holdings to scale faster than its competitors. We believe that the Company's strength in the European market is a structural competitive advantage over rival Expedia Group (Nasdaq:EXPE) and other OTAs.

As a result of its scale and competitive position, Booking Holdings generates impressive and stable 37% EBIT margins. The Company's largest expense item by far is its advertising spending to generate customer traffic to its booking platforms. In 2018, advertising represented 34% of the Company's revenues and the majority (54%) of operating expenses. Given the significance of advertising spending, it is a key variable of the Company's ultimate profitability. Booking Holdings' scale allows it to consistently spend more than its competitors on advertising including on online performance ad auctions. The Company benefits from spreading this large cost over its larger base.

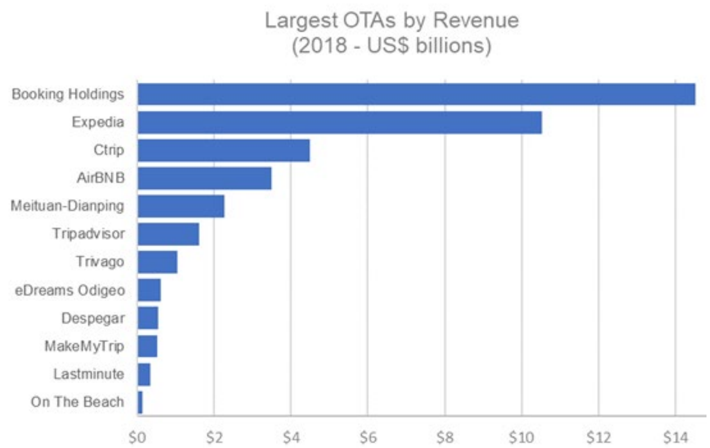
The OTA business is capital light. Booking Holdings' tangible assets stood at $656 million at year end consisting of mostly computer equipment and software. The Company's capital expenditures have averaged only 1.6% of revenues over the past decade. Returns on equity are ~40% and returns on tangible equity over 100%. This is an excellent business that generates a tremendous amount of free cash flow. Booking Holdings' free cash flow has exceeded GAAP net income in each of the last 11 years.

Long-term free cash flow generation is our favourite metric as we believe that the value of any business is the amount of cash that its owners can extract from the business over its useful life.

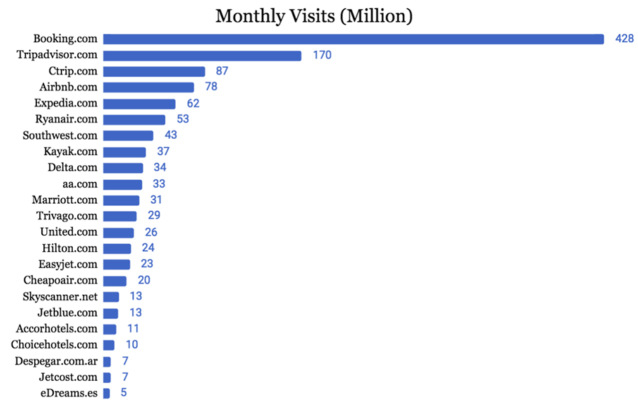
OTA Industry and Moats

The OTA industry has significantly consolidated through Booking Holdings' and Expedia Group's multiple acquisitions of brands over the past decade. As a result, the two companies have emerged as a virtual duopoly outside of China. Emerging competitor Airbnb has established itself as a formidable number-three player with its leading position in the alternative accommodations segment. Airbnb is also trying to enter the hotel booking market through its just-completed acquisition of HotelTonight.(1)

1. *Source: https://press.Airbnb.com/Airbnb-signs-agreement-to-acquire-hoteltonight/. See also https://techcrunch.com/2019/04/15/airbnb-officially-owns-hoteltonight/.*



Source: Company filings, CapitalIQ, GreensKeeper estimates



Source: Medium.com (2)

In addition to OTAs, travel demand aggregators take the form of metasearch engines that compile useful travel information and comparative booking options. The distinction in business models with OTAs is that metasearch websites sell advertising to OTAs and travel suppliers in exchange for prominent placement and hand off the booking itself to these advertising customers. Leading travel metasearch websites include TripAdvisor, Google Travel, Google Hotels, Kayak (owned by Booking Holdings) and Trivago (controlled by Expedia Group).

Booking Holdings' Brands

2. Source: https://medium.com/traveltechmedia/online-travel-metrics-traffic-marketing-channels-mobile-12ae78a84029.

Expedia Group's Brands:

We believe that the two largest OTAs will prove difficult to disrupt as they benefit from several moats working in combination: network effects, scale and to a lesser extent brands and switching costs.

<u>Network Effects</u>: The ability of the largest OTAs to offer travelers a vast selection of instantly bookable properties attracts consumers. Their huge consumer traffic makes participation on their platforms attractive to hotels that have room availability. This is a reinforcing feedback loop that is self sustaining. As the market matures, it naturally leads to a market structure whereby the dominant OTAs take most of the industry market share and profits.

Large chain hotels have the resources and scale to market directly to consumers, however, smaller independent/boutique hotels do not. Booking Holdings is particularly strong in Europe where a much larger percentage of hotels are independents/boutiques. We believe that the Company's strength in the European market is a structural competitive advantage over rival Expedia Group and other OTAs.

<u>Scale</u>: The scale of the largest OTAs allows them to spend vast amounts on advertising to drive traffic to their platforms (websites and apps). In 2018 Booking Holdings and Expedia Group spent \$4.9 billion and \$4.7 billion respectively on advertising and related activities. Compare those figures with Marriott International—one of the world's largest hotel chains—that spent \$660 million on advertising last year.

As a result of their scale and enormous advertising budgets, the two dominant OTAs generate massive consumer traffic and enjoy an advantage over accommodation suppliers themselves in terms of customer acquisition costs.

Brands: Travelers want to know that they are booking with a property that delivers as advertised and that they are dealing with reputable travel agents that can handle issues when they arise. Over time, Booking Holdings has built trust with its customers. The Company nurtures and deepens its relationships with travelers via direct marketing and loyalty programs. Travelers then become repeat customers and start to come directly to the Company's platforms (versus third-party referral).

Switching Costs: There are no switching costs on the demand side of the Company's network. Consumers can easily switch between OTAs. However, the same is not true on the supply side of the network. Accommodations suppliers need to integrate their live room availability and pricing with OTA technology platforms. Adding and maintaining room inventory to additional OTA platforms takes effort and can be burdensome for smaller independent hotels that lack resources and technical sophistication.

Industry Tailwinds

We believe that the OTA industry benefits from two major secular trends that are likely to persist for decades:

Tailwind #1 – Incomes are rising globally, especially in emerging markets. As they do, the percentage of the population able to afford to travel (demand) is increasing.

Tailwind #2 – The percentage of travelers who book accommodations online continues to increase. Booking Holdings and industry analysts estimate that less than 50% of leisure bookings are currently done online.[3] Traveler behavior continues to shift from physical travel agencies to online booking. In addition, smartphones are becoming ubiquitous, even in emerging markets. This change makes OTA platforms available to customers that were previously inaccessible.

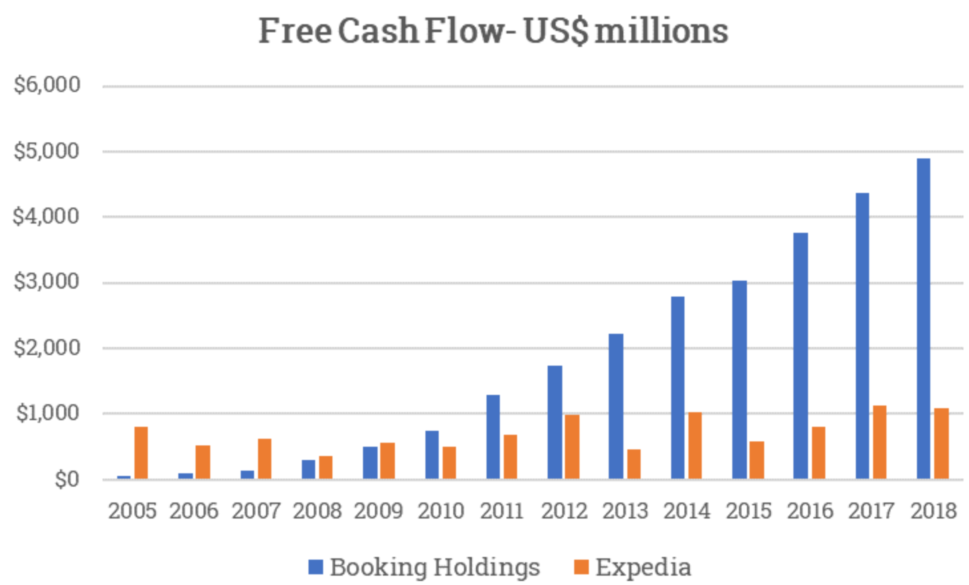
The combination of these tailwinds along with multiple moats have resulted in Booking Holdings' and Expedia Group's impressive growth:

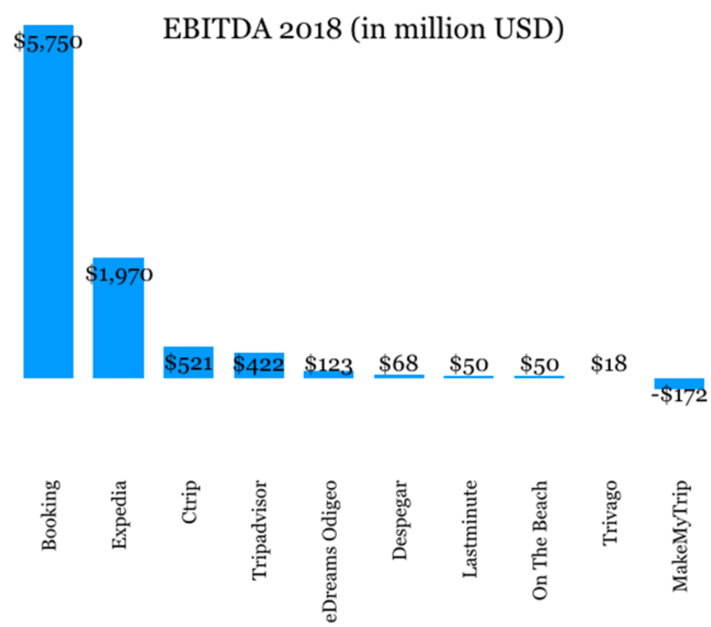
3. *According to Phocuswright, an independent travel, tourism and hospitality research firm, in 2019, over 45% of U.S. and European leisure and unmanaged corporate travel expenditures are expected to occur online.*

Management

As the gross booking chart on the prior page illustrates, Booking Holdings and Expedia Group have roughly comparable gross booking volumes at present with Booking Holdings having grown more quickly over the past decade. However, the similarities between the two companies stops there.

In our opinion, Booking Holdings has consistently been better managed as evidenced by their financial results. The following chart is illustrative:





The operation of network effects and scale naturally leads to a market structure whereby the dominant OTAs take most of the industry market share and profits (a "winner take most" market).

By our calculations, Booking Holdings generates more EBITDA and more free cash flow than all other OTAs combined—see bar chart at right.[4]

4. Source: https://medium.com/traveltechmedia/the-state-of-online-travel-agencies-2019-8b188e8661ac .

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In addition to Booking Holdings' superior execution vis-à-vis Expedia Group, we admire the approach taken by the management team at Booking Holdings in several respects.

Rational Capital Allocators. Having emerged from the industry's consolidation as the dominant player, Booking Holdings has started to use its growing cash flows to aggressively repurchase its own shares. To borrow a phrase coined by Charlie Munger, they are fast becoming a corporate cannibal.

Booking Holdings spent $6 billion on share repurchases in 2018 and its weighted average share count in Q4 2018 declined 4.3% year-on-year. The Company expects to spend at least $4.5 billion on share repurchases in 2019. Somewhat counterintuitively, the current undervalued share price is beneficial to existing shareholders as it magnifies the impact of these share repurchases.

Stock options have not been granted since 2015, PSUs/RSUs are used sparingly and management owns over $200 million worth of stock. As a result, they think and act like business owners.

> *"I'm a shareholder. I believe in, don't have your cash just sitting at extremely low interest rates, just for, to have, what? To have a lot of cash on the balance sheet? That if we don't have a good use for it, we should be thinking about how we can give it to other people to do it better. However, then maybe there will be some opportunities down the road, we don't know, that we'd want to use it and that would change things right now. I'm very pleased with the pace that we're going at in returning cash to our shareholders, and I also recognize that if there are opportunities down the road, we may use that cash some other way that we believe is a better opportunity, a better return for the shareholders, of who I am one."*

Glenn D. Fogel - CEO (Dec. 4, 2018 – Morgan Stanley conference)

The Company consistently maintains a healthy cash balance ($6.2 billion at year end) in order to be positioned to react quickly to M&A opportunities. In fast-growing travel markets like China and Southeast Asia the Company has a multi-pronged strategy. Booking Holdings participates directly (e.g. 1,000 employees and 12 offices in China) but has also invested directly in and entered into partnership agreements with emerging leaders. Booking Holdings' holds $8.4 billion of long-term investments on its balance sheet that include investments in Ctrip, Meituan Dianping, Didi Chuxing and Grab.

Culture. The Company's Chairman (Jeffery Boyd) and CEO (Glenn Fogel) have both been with the Company for 19 years. Booking Holdings' strategy is to constantly experiment and test and rely on data-centric analysis. They are constantly striving to improve on their consumer offerings and to maximize advertising ROIs through low-risk incremental improvements.

> *"… we're not a Company that makes seismic changes immediately. Our whole philosophy is doing things incrementally, carefully, measuring those changes with understanding what the data is telling us and then adjust again…. our DNA is one of test and learn, test and learn."*

Glenn D. Fogel - CEO (Nov. 7, 2017 – RBC Capital Markets conference)

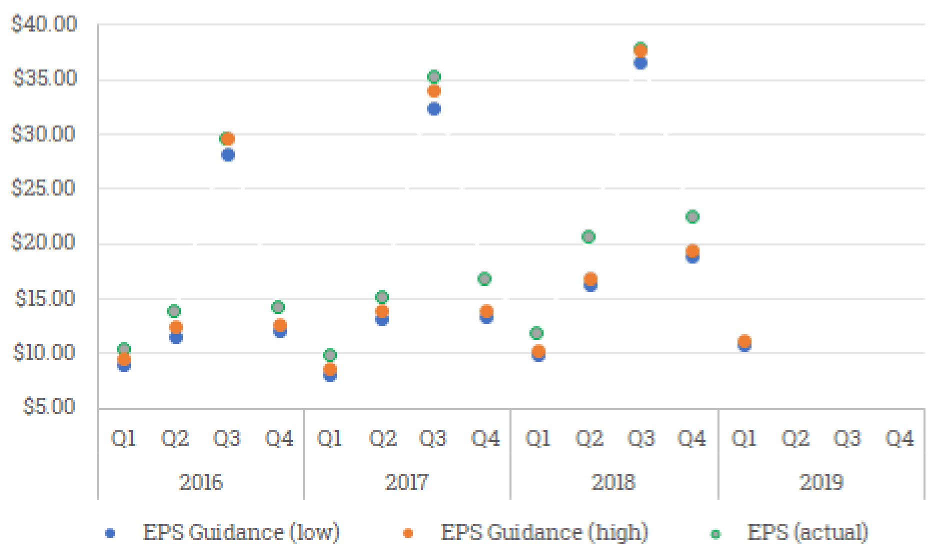
The management team is also remarkably honest and candid with their shareholders. When asked about the weakening macro environment in Europe last month, the Company's CEO had this to say:

> *"Look, you all read the same newspapers I read. And you look at the same reports that I look at and trying to predict macroeconomic future is, whether it be a quarter out or 10 years out, a very difficult thing to do. However, I will say that we want to give our guidance, we talked that we saw some softness and we talked about how -- we saw January was slower than December in Western Europe. We saw February was -- sort of popped a little bit back up, above January, but hadn't reached December yet. And that's about the best we tell on where we see things. Because I'm not going to lie and try and think about -- if you can tell me what's going to happen with Brexit, if you can tell me what's going to happen with yellow vests protests, if you can tell me what's going on with the Italian government in terms of their debt and the ECB, if you can tell me what's going to happen with the German car production because we have these trade wars with U.S.-China that's impacting the amount of cars that are being sold that are German produced, if you can tell me all those things, I'll still say I don't know. I do know this, though. I know in the long run, I absolutely know in the long run, travel continues to increase at a faster rate than global GDP, one. Two, I know that we, where we are positioned, we're going to get a higher share of that overall global growth. Those are positive -- I absolutely am certain of that."*

Glenn D. Fogel - CEO (Mar. 12, 2019 – BofA Merrill Lynch conference)

It is refreshing to see a CEO speak so candidly without the typical corporate spin. Despite their considerable success, they are remarkably humble. This is a management team that we are comfortable trusting our money with.

Long-Term Oriented. The Company provides guidance only one quarter forward and typically only after they are already halfway through the quarter. In addition, management's guidance is consistently conservative (see the scatter plot below).(5) In other words, they are sandbaggers. We appreciate their conservatism. We believe that for public companies, it is always best to under promise and over deliver.



5. *Source: Company filings, GreensKeeper.*

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This conservative approach to providing guidance is consistent with their practice of experimenting, reacting to opportunities as they arise and making decisions that are is best for the Company over the long-term.

In a recent quarterly earnings conference call, an analyst asked management for greater clarity on its guidance and the specific factors impacting the business. Management's response is insightful:

> *"… I understand where people are coming from with these questions and looking at the numbers for sort of guidance with us. But what I continue to try and do is have our investors and people that are looking at our Company is focus on the long term, what we're trying to grow, what we're trying to build, what's going to be great for customers and partners, so in the long run, we're able to achieve the mission, which really is to help people experience the world with less friction and more profits for us. That's what we're trying to do here.*
>
> *And some quarters are going to be better than expected. Some quarters are perhaps not going to be as good. And there's so much -- and again, I'll use the word dynamic. We got a lot of players in a market that are also bidding against us, bidding -- their own strategies. Brand advertising, we are trying to figure out what works, what doesn't work. Lots of factors happening. But as long as we continue to build our products, make things better for the customers, create what I talked about in the past about this holistic system that really makes it easier for people to travel. As long as we focus on that and continue to do that, I believe, in the long run, we will continue to grow this Company at a reasonable rate."*
>
> Glenn D. Fogel - CEO (Nov. 5, 2018 – Q3 2018 earnings call)

Like any management team, they aren't perfect. For example, Booking Holdings likely overpaid in their $2.6 billion acquisition of OpenTable in 2014 leading to a $941 million goodwill write-off in 2016. But their track record of success, shareholder-friendly actions and candour leads us to view them favourably.

Growth Initiatives

The Company's core accommodations booking market on its own should provide attractive growth prospects for the Company for years to come. Emerging markets are still underpenetrated and the Company is focusing on increasing its business in China and Southeast Asia. Alternative accommodations now count for 20% of the Company's revenues and is growing quickly.

In addition to its core business, management continues to look for new opportunities to leverage the Company's existing platforms, strengths and market position. The Company expanded into restaurant reservation bookings through its acquisitions of OpenTable in 2014. The company also looks for product extension opportunities for its travel customers including offering attraction booking services. Over time the Company will continue to leverage its position to expand into new areas.

Valuation

One criticism of Booking Holdings is that their growth rate is slowing. Given the Company's size, slowing growth rates are inevitable. However, there will be quarterly fluctuations that exceed the long-term trend which we believe the market often overreacts to.

Booking Holdings describes their market share of the worldwide room booking market as being "mid-single digit". By our estimates, in the 12-year period ended 2017, international travel spending grew somewhere in the range of 4-6% per annum. Over that same period, Booking Holdings grew its gross bookings at 35% per annum.(6) Despite its increasing size, gross bookings have never grown at less than 10% during that 12-year period and they grew 14% in 2018.

There will inevitably be recessions that lower both leisure and business travel demand. This will likely lead to reduced growth rates or even temporary declines despite the Company's outsized exposure to faster-growing international markets.

However, we believe that the Company can continue to grow both revenues and earnings well in excess of global GDP growth. We don't know the exact figure, but provided that the industry's competitive duopoly remains stable, long-term growth in excess of 5% per annum seems very reasonable.(7) The reported figure will be distorted from time to time due to foreign exchange effects and the size of the Company's international business. Combined with significant share repurchases, intrinsic value should continue to compound at double-digit rates for years to come.

Given the high-quality of the business, its low capex, high free cash flow and its growth prospects, we believe that the business is worth at least 20x owner earnings. Our estimate for 2019 owner earnings is approximately $100 per share. With current cash and long-term investments of $322 per share, we believe the shares are worth at least $2,300.

Our equity valuation ignores the $8.7 billion of debt in our equity valuation as it is maintained at an appropriate level (1.5x Gross Debt/LTM EBITDA and 2.0x LTM FCF). If we were to net the debt against cash and long-term investments and assume that the Company operates on a debt-free basis, this still produces a fair value of over $2,100 per share compared with the current share price of $1,844.

At the current stock price, the stock trades at a below-market multiple for an above-average Company in terms of quality and future growth prospects. Booking Holdings is currently trading at the lower end of its 5-year EV/EBIT range (see chart below).(8) For all of the foregoing reasons, we believe that the stock is attractive at current prices.

6. Sources: GreensKeeper estimates, UNWTO Tourism Highlights 2018 Edition, Deloitte travel and hospitality industry outlook.
7. Statistica projects online travel booking revenue to grow in excess of 6.5% per annum over the next five years. See also https://seekingalpha.com/article/4245434-booking-holdings-stock-booked-growth-investors.
8. Source: S&P CapitalIQ.

As one final check, we compared the current valuation of Booking Holdings with Airbnb which is expected to launch an IPO in 2019.

As a private Company, there is limited data available on Airbnb. However, press memos issued by the Company disclose that Airbnb was profitable "on an EBITDA basis" in 2017 and 2018 and that the Company recognized substantially more than $1 billion in revenue in Q3 2018.(9) Given the seasonality of the travel business, we guestimate that Airbnb generated approximately $4.2 billion in revenue in 2018 and that the Company is not yet profitable at the net income line.

The alternative accommodations business represents 20% of Booking Holdings' revenue and is growing faster than the Company's traditional segments. The number of alternative accommodation listings on Booking Holdings' platforms is comparable to Airbnb, but the Company currently lags in terms of revenue.

Given the higher touch nature of the segment, it is lower margin business than the traditional OTA business. However, given Booking Holdings' existing infrastructure and the efficiencies gained through its scale, its alternative accommodations business is already "nicely profitable".(10)

	2018	
	BKNG	**Airbnb**
Revenue from Alternative Accommodations	$2.8 billion	$4.2 billion
Alternative Accomodation Listings (#)	5.7 million	> 6 million
Hotel Rooms*	23.3 million	6 million
Alternative Accomodations as % of Total Revenue	20%	99%
Profitable?	Yes	at EBITDA line
Company Equity Valuation	$83 billion	$35 billion

Source: Booking Holdings management, GreensKeeper estimates. (9)

Airbnb's last fundraising round valued the company at $35 billion.(11) We do not use relative valuations to justify our investments, especially when the comp is likely overvalued as we believe Airbnb to be. We will just say that given Booking Holdings' history of execution, we would not be against them in the alternative accommodations space.

> *"Some people say, 'You're never going to catch up to [Airbnb]. Well, maybe no, maybe yes. I do point out, though, that we were a fraction of the size of the leaders in 2005, 2006, 2007. And now, we are so far ahead of them, so it does happen. And I think it's not rocket science here. It's good execution. It's working really hard. It's spending the money in the right way, and we should be able to achieve. Even if we don't achieve leadership in every territory, we will continue to improve upon what we currently have and result in a very big business."*

Glenn D. Fogel - CEO (Nov. 7, 2017 – RBC Capital Markets conference)

9. *Sources: https://press.Airbnb.com/Airbnb-2019-business-update/. See also https://skift.com/wp-content/uploads/2018/11/Airbnb-Memo.pdf and https://skift.com/2019/03/01/Airbnbs-response-to-booking-com-weve-got-more-listings/.*
10. *CEO Glenn Fogel on Booking Holdings' Feb. 27, 2019 conference call.*
11. *https://www.recode.net/2019/3/19/18272274/Airbnb-valuation-common-stock-hoteltonight.*

Risks

Economic Slowdowns. Travel spending is largely discretionary and thus cyclical. During economic downturns, business and leisure travel both decline. That said, analysts and industry participants have commented that OTAs aren't especially sensitive to economic weakness. For example, on its fourth-quarter conference call, Expedia Group's management stated that people still travel during slowdowns—they just take shorter, less expensive trips. Management recently added that Expedia Group had "some of its strongest core profit growth" in 2008-09, during the global financial crisis.[12]

While Booking Holdings and Expedia Group both continued to grow during the Great Recession that began in 2008, we would make two observations. First, growth rates did in fact decline during that period but the underlying secular shift to online booking overcame the broader economic weakness. Second, with the OTA industry having captured a larger share of overall travel bookings, we believe that future recessions could result in revenue declines, albeit for a short duration. The underlying trend of above-average GDP growth for the industry should remain intact for years to come.

Emerging Competitors. We believe that the biggest risk to an investment in Booking Holdings is the emergence of a competitor that disrupts the OTA duopoly by stealing significant market share or by capturing a greater portion of the economics of the OTA ecosystem.

Potential disrupters are likely to come from digital platforms with large organic traffic (e.g. Airbnb, Amazon, Facebook, Apple). We discussed Airbnb in the Valuation section above. Below we evaluate several additional potential competitors and why we believe that they will be unlikely to disrupt the status quo.

Metasearch Engines

Certain travel demand aggregators take the form of metasearch engines that compile useful travel information and comparative booking options. Metasearch websites sell advertising to OTAs and suppliers in exchange for prominent placement and have traditionally handed off the booking itself to these advertising customers. Leading travel metasearch websites include TripAdvisor, Google Travel, Google Hotels, Kayak (owned by Booking Holdings) and Trivago (controlled by Expedia Group).

Consumers select the travel offering that they want to book by clicking on the appropriate link and are handed off to the OTA to complete the booking. The OTA pays a fee to metasearch engine for that click. These fees and the prominence of the placement on the metasearch website are based on live online auctions that OTAs and others continually bid on (referred to as performance-based advertising).

So why wouldn't these travel metasearch engines get into the OTA business directly and complete the booking themselves? A few have tried but have been unsuccessful to date. By analyzing the most recent failure by TripAdvisor we can illustrate the difficulty of making that transition.

TripAdvisor (Nasdaq:TRIP) is a travel website with over 500 million average monthly unique visitors. In 2014, TripAdvisor launched its Instant Booking offering which allowed travelers to book hotel rooms without leaving the TripAdvisor website. In order to participate in this program, OTAs and/or suppliers were required to pay a commission to TripAdvisor. Participating OTAs were effectively giving up a share of their commissions in lieu of bidding via performance-based ad auctions.

12. https://www.wsj.com/articles/booking-com-is-a-suite-deal-after-tumble-11551373428.

Booking Holdings and Expedia Group initially refused to participate in TripAdvisor's Instant Booking offering. Eventually, Booking Holdings participated but only after negotiating what we viewed as favourable terms including prominent branding and a period of exclusivity. At the time of their participation, Booking Holdings concurrently reduced their performance-based advertising spend on the TripAdvisor website.

At the time of this initiative, Booking Holdings and Expedia Group represented 46% of TripAdvisor's revenue. As a result of this buyers strike, TripAdvisor's revenues stagnated for the next four years.

> *"In performance-based channels, competition for top placement has reduced ROIs over the years and been a source of margin pressure, with an increasing share of the unit economics accruing to the benefit of our advertising partners.* ***This has been a concern to us since some of these partners use our advertising dollars to compete with us in the advertising funnel and represent themselves as places to not only research travel, but also book it. We are looking at each channel and managing them to ensure that we are supporting channels which deliver appropriate ROIs, treat our conversion-friendly product displays fairly and offer a superior consumer experience with the overall goal of building our direct traffic over time." [Emphasis added]***

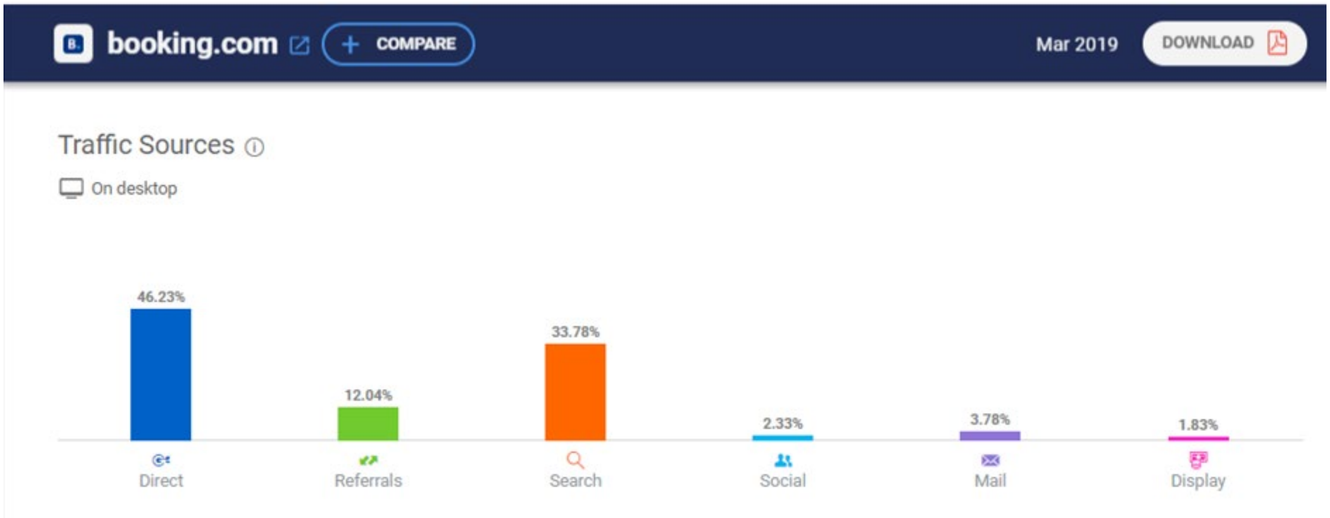
Glenn D. Fogel - CEO (Nov. 6, 2017 – Q3 2017 earnings call)

> *"Then Google is, as we've said over the years, by far, our biggest performance marketing channel. And so it also was evaluated as part of our review of our performance marketing spend to see what should be the -- where should we look to improve our ROIs.* ***I'd say one thing that's different with Google is they're not competing with us and other performance marketing channels for our customers, and so that's a positive difference between Google and some of the other channels.*** *We're still fully participating in Google, although we have looked to improve ROIs on the margin there as well."* ***[Emphasis added]***

Daniel J. Finnegan - CFO (Nov. 7, 2017 – RBC Capital Markets Conference)

The Instant Booking experience with TripAdvisor helped Booking Holdings to recognize its vulnerability in having to pay for referral traffic to companies that could potentially compete with them. Consequently, the Company started to more aggressively market its services directly to consumers (primarily via brand advertising on television).

As a result of this tactical shift, consumer behavior is evolving. The direct channel (travelers that start their travel search directly on the Company's platforms) now represents over 50% of the Company's business. This percentage continues to grow and is growing at a faster rate than the Company's overall growth. In other words, Booking Holdings is growing its consumer brand and gradually becoming less and less reliant on third-party traffic which they have to pay for.



Source: see note.[13]

After launching Instant Booking, TripAdvisor struggled to grow the business meaningfully. Management repeatedly cited technical challenges in getting hotel clients integrated and the lack of sophistication of independent hoteliers. TripAdvisor also acknowledged their reliance on the OTAs to provide customer support to travelers. In other words, the dirty work of signing up thousands of hotels and dealing with issues affecting travelers is difficult.

Another challenge is that travel is a global business. Travelers speak many languages and websites and customer service agents need to be able to handle this diversity and complexity. Booking Holdings has 24,500 employees located in more than 300 offices around the world. Over two-thirds of those employees are client facing (dealing directly with hotels or travelers).

> *"It's a lot of dirty work. Both Google and TripAdvisor already make a pretty fair share of the economics of a transaction without doing any of the dirty work of supply acquisition and customer service. So, I think they're going to continue to focus on what they're good at, and we'll continue to focus on what we're good at. And it's a good partnership with both Google and TripAdvisor for us."*

Daniel J. Finnegan, CFO (Mar 15, 2016 – BofA Merrill Lynch conference)

Rate parity agreements between OTAs and accommodation suppliers require that OTAs receive best (most-favoured nation) pricing. Hoteliers are free to set their own rates, but generally must provide OTAs matching rates. This ensures that customers booking through the OTA platforms know that they are getting the best pricing available.

13. *Source: SimilarWeb. Data for March 2019. Desktop only traffic.*

Changing laws in several jurisdictions now permit hotels to undercut OTAs in certain situations. However, the reality is that the OTA's market power effectively ensures that rate parity will continue to exist in practice.

As a result of these rate parity agreements, emerging OTAs are unlikely to be able provide lower prices to consumers. Disrupters may choose to lower commission rates charged which would make them attractive to hotel suppliers. However, these commission rates are invisible to (and irrelevant from the perspective of) the consumer. Consumers ultimately gravitate to travel websites with the best selection, prices and booking experience.

The dominance of Booking Holdings and Expedia Group and suppliers' reliance on their vast traffic creates a chicken and egg problem. Supplier inventory would remain on the two dominant platforms even if a new entrant offered a lower agency commission. Voluntarily removing supply listings from the largest travel demand platforms to provide exclusivity to a new partner would be risky. Any commission savings would not make up for the lost bookings until the new partner delivered similar traveler volumes. Suppliers would also face the risk that Booking Holdings and Expedia Group display their listings less prominently or remove their inventory from their platforms entirely.

Instant Booking remains on less prominent parts of the TripAdvisor website, but the Company is no longer promoting it. In other words, they have effectively dropped it without explicitly saying so.

We believe that other pure metasearch companies that attempt to move into the OTA space will experience a similar outcome. The OTA duopoly represents a large part of their advertising revenue which they would place at risk if they chose to directly compete. In addition, the infrastructure needed to replicate the OTA platforms is formidable and takes time and capital to put in place. Consequently, we view the threat from most metasearch players as low and if it does materialize, unlikely to succeed in displacing Booking Holdings' market leadership.

Other Digital Platforms

Certain digital platforms have the advantage of significant organic traffic. By becoming an OTA, travelers could complete their reservations without ever leaving their ecosystem. Unlike metasearch engines, a number of these companies do not face the risk of losing a significant amount of existing revenue (e.g. Amazon, Apple, Facebook). In addition, these companies have deep pockets and the ability to absorb significant losses during the start-up phase.

Nevertheless, these potential disrupters still face the daunting task of building up the global infrastructure and human resources necessary to compete with the dominant OTAs. Booking Holdings' and Expedia Group's infrastructure has been built up gradually over many years. It is difficult to replicate and costly to maintain. We also believe that the labour-intensive "dirty work" of running an OTA may be inconsistent with the culture of several of these firms (Apple and Facebook).

Amazon has tried to enter the travel market in the past on at least two occasions. The Company started Amazon Local and Amazon Destinations in 2015 but quickly shut down both initiatives.[14] Acquiring and then selling perishable hotel inventory is very different than selling physical merchandise.

14. *Source: https://seekingalpha.com/article/4157911-can-amazon-disrupt-online-travel.*

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We believe that Amazon, Apple and Facebook would all encounter the same rate parity and the chicken and egg issues discussed above. We are not naïve in thinking that it is impossible for these companies to try to enter the OTA space. But in our opinion, the risk is low and if they do, we believe that they are unlikely to succeed in displacing Booking Holdings' market leadership.

Alphabet Inc. (Nasdaq:GOOG)

We view the threat of Alphabet Inc.'s Google division ("Google") entering the OTA market to be the biggest risk to our investment in Booking Holdings and thus deserving of its own discussion.

Google's search dominance and scale provide the company with millions of travelers that come to their properties directly to search for suitable travel bookings. Google also operates its own metasearch platforms: Google Flights, Google Hotels and the Google Trips app. Google currently monetizes this organic travel-related traffic by selling advertising to third-parties including OTAs, metasearch firms and travel suppliers.

It has been reported that Booking Holdings and Expedia Group are among Google's largest advertising cost-per-click customers.[15] These two OTAs alone spent over $9 billion on performance advertising in 2018, primarily with Google. For perspective, Google properties generated $96 billion of advertising revenues in 2018 and Google earns very high margins on that revenue.

Google has publicly denied on several occasions that its intention is to become an OTA. However, we recognize that telegraphing its true intentions would be unwise and that even if these statements were true when made, things can change.

Given their many strengths, we do not take the threat of Google's possible entry into the OTA market lightly. Google would be a formidable competitor with the deepest of pockets. We conducted a thought experiment to determine how an entry into the OTA market by Google would likely unfold:

> Suppose that Google announces that it is launching its own OTA and attempts to sign up millions of travel suppliers to their platform. The response of the large OTAs including Booking Holdings and Expedia Group would likely be an immediate and material reduction of their advertising spend with Google (similar to Booking Holdings' reaction to TripAdvisor's Instant Booking initiative). Those dollars would largely shift to other media.
>
> The bulk of Booking Holdings' and Expedia Group's performance-based advertising is currently spent with Google. If we assume 80%, this would represent a potential loss of $7.3 billion of high-margin revenue to Google.
>
> Booking Holdings' recent strategy of allocating more of its advertising dollars to direct-to-consumer brand advertising positions them to be slightly less reliant on Google if they were to enter the OTA space as a direct competitor. Over 50% of Booking Holdings' revenue comes to them via direct channels. This percentage continues to increase and is growing faster than overall revenue growth. As Google does not control any of this traffic flow, capturing a meaningful portion of this business would be difficult for Google.

15. *Source: https://www.cnbc.com/2018/11/05/travel-giant-booking-spent-1-billion-on-google-ads-in-the-quarter.html.*

Given this background, what are the net economics to Google if they proceed to launch an OTA? Booking Holdings is an efficient organization with the best OTA margins in the industry and yet they still spent $4.7 billion on non-advertising operating expenses in 2018. Google would likely need to spend a similar amount to properly compete as an OTA.

At launch, Google would not have a comparable number of listings to the large OTAs. These relationships and infrastructure have been built up over many years. Google would likely start in a few key markets and attempt to build out its offering over time.

Meanwhile, Booking Holdings and Expedia Group would no doubt continue to compete ferociously for every traveler and also use their negotiating leverage to make it challenging for accommodation suppliers to favour Google. The OTAs would likely increase their ad spending via other media channels and continue to build their own direct traffic via brand advertising.

The net result is that Google goes from earning $7.3 billion of high margin ad revenue to losing most (all?) of that revenue, adding considerable operating expense and personnel in the hope of capturing a material share of the travel booking market currently going to several of its largest customers. By our math, Google would need to capture a very high percentage of the current revenues of both Booking Holdings and Expedia Group to be economically better off.

Google would also face the same execution challenges as other digital companies in having to build up the necessary infrastructure—the "dirty work"—in order to effectively compete. Google would need to create both a sales organization to procure supply and customer service infrastructure in order to execute its OTA strategy. Their superior data (both in terms of quality and quantity) provide Google with no competitive advantage on this front.

The rate parity clauses would also provide no additional benefit to the consumer other than ease of use as they would not need to leave the Google platform to complete their booking.

Google's entry into the OTA market would start a war with two of its largest customers—Booking Holdings and Expedia Group. By doing so, it could ultimately destroy the economics of the business for all OTAs over the medium term in the hope of prevailing over the long term. But the financial risks to its own advertising business suggest to us that doing so at the present time would be unwise.

Given Google's strengths, it will likely pose a considerable long-term threat to the OTAs. Google possesses the means to take a long-term approach with a chance to successfully disrupt one or both of the dominant OTAs.

We believe that the more likely scenario will be a continued game of cat and mouse whereby Google tries to increase the value of its travel leads to its OTA partners by qualifying those leads more fully through its travel-related offerings. By doing so, OTAs will be willing to pay more for those leads due to their higher conversion rate and performance-marketing ROIs will continue to decline.

By pursuing this strategy, Google may be able to extract a growing share of the economics of a travel booking transaction without abandoning its core business model (paid search ads) or competing with its largest customers. It is a delicate balance as Google wants to engage users by adding travel-related information without alienating its largest OTA customers.

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> *"As a connector, we believe the more information and the better results we can provide to our users, the travelers, the better-qualified leads that we can provide to [advertisers]."*
>
> Rob Torres – Managing Director – Google Travel (16)

In light of this overhanging threat, Booking Holdings and Expedia Group will likely continue to increase their spending on building up their own brands and increasing their direct traffic. By doing so, they will gradually wean themselves off their reliance on Google for their traffic. As they become less reliant on Google's search traffic, the potential risk of Google morphing into a direct OTA competitor probably increases as Google will have less to lose at some point.

An announcement by Google of its entry into the OTA sector would negatively impact our assessment of our investment in Booking Holdings. We will remain vigilant and believe that the risk-reward of an investment in Booking Holdings is attractive at current market prices.

Disclosure: The GreensKeeper Value Fund and accounts managed by GreensKeeper Asset Management Inc. currently own shares of Booking Holdings and certain other securities mentioned in this report.

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16. *Source: https://skift.com/2018/09/27/googles-conflicted-travel-strategy-pushes-forward/. See also https://skift.com/2018/04/27/google-plans-to-string-its-travel-assets-together/.*

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