

Expedia, Inc.

March 23, 2017

GICS Sector Consumer Discretionary

Current Price \$129

Industry Internet & Direct Marketing Retail

3-Year Target Price \$275

Company Description Expedia, Inc is one of the largest online travel companies in the world. Operating under an umbrella of brands, Expedia caters to all needs of both leisure and corporate travelers. Expedia spun off trivago in 2016.

Investment Rationale

Expedia will benefit from increased consumer spending on travel experiences.

Consumer confidence is at historically high levels and many factors point to a healthy economy for the foreseeable future. Per a report released by Deloitte this year, the travel industry is positioned to benefit from a healthy labor market, which has boosted disposable income. Disposable income in the latter part of 2016 was up 3.4%.

After the financial crisis of 2008, growth in consumer spending on foreign travel in the U.S. declined significantly, much further than disposable personal income growth. In 2011, consumer spending on foreign travel reached pre-crisis levels and has grown notably faster than disposable income. We believe this trend will continue and that consumer confidence, coupled with increasing disposable income, will drive travel spending in the foreseeable future.

Synergies from integrated brands will act as a catalyst for growth while differentiating Expedia from its competitors. Expedia added three companies to its portfolio of brands in 2015, which have not been fully integrated into the company's operations. We believe the synergies and revenue impact from the acquired brands have yet to be realized. Expedia acquired Orbitz and Travelocity in 2015 to further consolidate the online travel agency industry. Orbitz drove growth in Engencia, increasing revenue by 16%. Expedia also acquired HomeAway in 2015 to address the market of alternative accommodations, a platform its primary competitor lacks. As these brands are integrated into Expedia's core platforms, they will expand the company's customer base, increase the number of bookable listings, and drive growth across all segments.

Expedia will continue to benefit from the secular shift towards digital travel bookings. Booking travel accommodations online is now commonplace and the portion of bookings done in this form will continue to increase.

Key Statistics

Market Cap	19.66B
P/E	76.28
Forward P/E	20.7
Beta	.77
Dividend & Yield	1.12 & 0.85%
52 Week Range	96.58 – 133.55

Revenue

	Q1	Q2	Q3	Q4	FY
2016	1,904	2,196	2,581	2,093	8,774
2015	1,373	1,663	1,938	1,699	6,673
2014	1,200	1,495	1,713	1,356	5,764
2013	1,012	1,205	1,402	1,152	4,771
2012	816.5	1,040	1,199	974.9	4,030
2011	822.2	1,024	1,141	787.1	3,774

Earnings Per Share

2016	(0.81)	0.21	1.18	0.51	1.09
2015	0.34	3.38	2.12	(0.09)	5.75
2014	(0.11)	0.67	1.94	0.50	3.00
2013	(0.77)	0.51	1.22	0.70	1.66
2012	0.15	0.76	1.20	0.04	2.15
2011	0.38	1.00	1.50	0.44	3.32

Risks

Metasearch engines limit Expedia's listings in search results

Suppliers of travel accommodations products and services, such as airline tickets and hotel bookings, directly to consumers pressures online travel agencies

Failure to integrate acquired companies into existing platforms could cause inefficiencies in the short-term

Business Summary

Corporate Overview Expedia, through its subsidiaries and brands, operates as an online travel agency in the United States and internationally. Expedia serves both leisure and corporate travelers through its extensive portfolio of brands: Expedia.com, Hotels.com, Orbitz, Trivago, HomeAway, Egencia, Travelocity, Hotwire, Expedia Media Solutions, Wotif Group, Classic Vacations, CarRentals.com, Expedia Local Expert, and Expedia CruiseShipCenters. These brands give travelers access to over 350,000 properties, 1.2 million bookable online listings in over 200 countries, 500 airlines, rental cars, cruises, and destination services and activities.

Reportable Segments

Core OTA is Expedia's core online travel brands. This segment can be broken into two platforms, Expedia.com and Hotels.com, both of which include a majority of Expedia's brands. Expedia.com is a full service online travel platform that's provides travelers access to airline tickets, lodging, car rentals, cruises, and activities and tours through its website and mobile app. Travelers have the option of purchasing these services as packages or on a standalone basis. This platform includes the following brands: Orbitz's, CheapTickets, Travelocity, Wotif Group, Expedia Local Expert, and Hotwire.com. The second core OTA platform is Hotels.com. Hotels.com is geared primarily towards lodging accommodations. With 89 localized sites in 39 languages worldwide, Hotels.com acts as Expedia first point of contact into new markets.

Egencia is Expedia's full-service corporate and business traveler brand. This segment offers managed travel services to corporate travelers worldwide. Egencia operates in over 65 countries across North America, Europe, and Asia. This platform operates on an account basis in which Egencia charges corporate travelers account management fees and transaction fees.

HomeAway is Expedia's online marketplace for vacation rentals and its response to the growing trend of alternative accommodations. This platform markets over one million listings in over 190 countries. It does so through the following brands: VRBO; Stayz, an Australian based vacation rental marketplace; Abritel, a French based vacation rental marketplace; OwnersDirect; Homelidays; and BedandBreakfast.com.

trivago is a hotel metasearch engine that provides price comparisons for over 1.3 million hotels in 190 countries. trivago operates over 55 localized websites and its mobile application, which are all offered in 33 languages. This segment generates advertising revenue primarily from sending referrals to online travel companies and travel service providers.

Company Information

Founded 1996

Headquarters Bellevue, WA

Employees 20,075

Leadership

President & CEO	Age
Dara Khosrowshahi	47
CFO & EVP, Operations	
Mark D. Okerstrom, MBA	44
Secretary, Executive VP	
Robert J. Dzielak	46
CAO & Controller	
Lance A. Soliday, CPA	44
SVP Global Marketing	
Cyrill Ranque	47
Investor Relations	
Alan Pickerill	50

Competitive Analysis

Expedia competes with both established and emerging companies in the online travel market. The company's main competitor is Priceline Group. Like Expedia, Priceline markets travel services through a variety of brands and subsidiaries. Expedia's Hotels.com and Priceline's Bookings.com compete directly for hotel bookings; Expedia.com and Priceline.com compete for services such as hotel and lodging, airline, car rentals, and cruises; and trivago competes with KAYAK to find the best deals on hotels. Although both companies offer similar services, Expedia has an advantage over Priceline with HomeAway and Expedia Local Expert, which allows customers to search for activities and experiences in a variety of cities around the world. Expedia also competes with companies like Google and Airbnb. Google provides both airline travel services and hotel booking services through its search engine. Expedia offers the same flights and hotels at lower or matched prices. Airbnb is an emerging competitor in the online travel market with its rental-by-owner business model. Airbnb offers alternative accommodations and experience packages to travelers in 190 countries. Expedia entered in 2015 when it acquired HomeAway. Expedia also faces competition from traditional travel agencies and large hotel brands, which push for direct bookings. This is not a major concern for Expedia because traditional travel agencies are losing market share to OTA's and Expedia has substantially more properties offered than any given hotel chain.

Sector Outlook

Year-to-date, the consumer discretionary sector is outperforming the S&P 500, realizing a 6.0% rise in price versus 4.4% for the S&P 500. Recently, the consumer discretionary space has experienced major disruption. The purchasing habits of millennials has shifted growth within the sector away from mall traffic and retail locations to mobile and online shopping. This disruption is further exacerbated by the increasing number of tech startups that can undercut the pricing of competition while often operating without profit. For this reason, it is important for investors to seek out consumer discretionary companies with strong brands that are constantly seeking innovation. Without strong brands and innovation, consumer discretionary companies will find themselves treading water in an environment plagued by increasing price transparency and easier substitution that has resulted from the move to the e-commerce environment. Fortunately, Expedia's well-known portfolio of brands aids in its ability to dominate in its market.

A Note Regarding the trivago Spinoff

It is important to note that the trivago IPO is different than the previously completed TripAdvisor spin-off. Expedia did not actually relinquish any of its shares of trivago during the IPO process. However, this was not the only reason for the spinoff. When Expedia acquired trivago in 2012, both companies agreed to add put and call option rights to the sale. This meant that trivago had the right to sell their remaining shares to Expedia at a reasonable price and Expedia had the right to purchase the remaining shares of trivago at a reasonable price if the decision was made before the option expiration date. The first expiration date for the contracts came in December 2015, but, because both companies agreed to consider the possibility of an IPO the deadline was extended significantly. Lastly, like the TripAdvisor spinoff, Expedia's CEO made statements about the transaction's potential to unlock unrealized value for both companies.

Methodology & Valuation

EBITDA Calculation

To calculate EBITDA, we evaluated its historical relationship to revenues (past five years). We recognized that EBITDA as a percentage of revenue has not deviated from a tight range. For this reason, we calculated EBITDA based on the average percentage of revenue that it has accounted for over the period.

EBITDA (% of Revenue)					
	2012	2013	2014	2015	2016
Revenue	4030	4771	5763	6672	8774
EBITDA	803	879	1025	1103	1616
% of Revenue	19.92%	18.42%	17.78%	16.53%	18.42%

Valuation

Average 18.21%

To value Expedia, we created an EBITDA multiple model based on the historical relationship between the market and the company's financial performance. We chose this technique because it is discussed in the company's 10-k as an adequate method for assessing the fair value of the company.

To properly assess the company, we compared its historical EBITDA multiple (past five years) with that of its primary competitor. We recognized the trend of an expanding EBITDA multiple due to high growth rates and high growth prospects for the company. Given the fact that its largest competitor, in an industry considered a duopoly, trades at much higher EBITDA multiples than Expedia, we believe that the company will continue to experience multiple expansions until the multiple reaches this level.

Results

Due to these assumptions and calculations, we believe the company has a current value of **\$155** a share, which implies in an undervaluation of approximately 20%.

We derived a 3-year price target of **\$275** on the stock.

EXPE Historical EBITDA Multiple

	2012	2013	2014	2015	2016
EBITDA	803	879	1025	1103	1616
SHROUT	140	140	133	134	155
EBITDA/Share	\$5.74	\$6.29	\$7.70	\$8.23	\$10.46
Avg. Price	\$44	\$57	\$77	\$107	\$112
EBITDA Multiple	7.71x	9.05x	9.98*	13.02x	10.70x

*Multiple is an outlier due to the sale of eLong. Effect considered in analysis.

PCLN Historical EBITDA Multiple

	2012	2013	2014	2015	2016
EBITDA	1889	2498	3286	3561	3230
SHROUT	51	52	53	52	50
EBITDA/Share	\$36.81	\$47.66	\$61.97	\$69.02	\$64.52
Avg. Price	\$630	\$878	\$1,198	\$1,220	\$1,346
EBITDA Multiple	17.13x	18.42x	19.33x	17.67x	20.87x
Average Multiple	18.69x				

Valuation

	2017	2018	2019	2020	2021
EBITDA	1836	2091	2360	2641	2902
SHROUT	155	155	155	155	155
EBITDA/Share	\$11.88	\$13.53	\$15.28	\$17.09	\$18.78
Applied Multiple	13.08x	14.08x	15.08x	16.08x	17.08x
Fair Value	\$155	\$190	\$230	\$275	\$321

Methodology & Valuation

Sensitivity Analysis

The accuracy of our price forecast is highly dependent on Expedia's number of outstanding shares in the associated future period and the expected price to EBITDA multiple. Because of this, we have created a sensitivity analysis to model the impact of potential deviations from our projected EBITDA multiple and the number of outstanding shares.

	13.09x	13.78x	14.51x	15.27x	16.08x	16.88x	17.72x	18.61x	19.54x
120	\$289.24	\$304.46	\$320.48	\$337.35	\$355.11	\$372.86	\$391.50	\$411.08	\$431.63
126	\$274.77	\$289.24	\$304.46	\$320.48	\$337.35	\$354.22	\$371.93	\$390.53	\$410.05
132	\$261.04	\$274.77	\$289.24	\$304.46	\$320.48	\$336.51	\$353.33	\$371.00	\$389.55
139	\$247.98	\$261.04	\$274.77	\$289.24	\$304.46	\$319.68	\$335.67	\$352.45	\$370.07
147	\$235.58	\$247.98	\$261.04	\$274.77	\$289.24	\$303.70	\$318.88	\$334.83	\$351.57
155	\$223.81	\$235.58	\$247.98	\$261.04	\$274.77	\$288.51	\$302.94	\$318.09	\$333.99
162	\$213.15	\$224.37	\$236.18	\$248.61	\$261.69	\$274.77	\$288.51	\$302.94	\$318.09
170	\$203.00	\$213.68	\$224.93	\$236.77	\$249.23	\$261.69	\$274.77	\$288.51	\$302.94
179	\$193.33	\$203.51	\$214.22	\$225.49	\$237.36	\$249.23	\$261.69	\$274.77	\$288.51
188	\$184.13	\$193.82	\$204.02	\$214.75	\$226.06	\$237.36	\$249.23	\$261.69	\$274.77
197	\$175.36	\$184.59	\$194.30	\$204.53	\$215.29	\$226.06	\$237.36	\$249.23	\$261.69

Proformas

Proforma Income Statement								
	2014	2015	2016	2017	2018	2019	2020	2021
Product								
Revenue	5,763,485	6,672,317	8,773,564	10,079,868	11,479,869	12,959,520	14,500,289	15,934,367
Cost of revenue	1,179,081	1,309,559	1,596,698	1,730,615	1,841,327	1,932,291	1,998,256	2,195,756
Gross Profit	4,584,404	5,362,758	7,176,866	8,349,253	9,638,543	11,027,228	12,502,032	13,738,611
Operations								
Selling and marketing	2,808,329	3,381,086	4,367,417	5,118,490	5,889,846	6,717,228	7,592,193	8,426,959
Technology and content	686,154	830,244	1,235,019	1,509,934	1,470,376	1,659,894	1,857,240	2,040,922
General and administrative	425,373	573,913	678,292	832,086	967,780	1,115,236	1,273,247	1,427,105
Amortization of intangibles	79,615	163,665	352,031	260,731	245,598	148,585	113,311	77,995
Other	67,169	284	82,405	45,240	34,440	38,879	43,501	47,803
Operating Income	517,764	413,566	461,702	582,773	1,030,503	1,347,406	1,622,540	1,717,828
Other								
Other income (expense)	(53,123)	512,396	(185,102)	(185,102)	(185,102)	(185,102)	(185,102)	(185,102)
Pretax income	464,641	925,962	276,600	397,671	845,401	1,162,304	1,437,438	1,532,726
Provision for income taxes	(91,691)	(203,214)	(15,315)	(81,522)	(173,307)	(238,272)	(294,675)	(314,209)
Net Income	372,950	722,748	261,285	316,148	672,094	924,032	1,142,763	1,218,517
Minority Interest	25,147	41,717	20,563	20,563	20,563	20,563	20,563	20,563
Total Net Income	398,097	764,465	281,848	336,711	692,657	944,595	1,163,326	1,239,080

Key Balance Sheet Items							
	2015	2016	2017	2018	2019	2020	2021
Assets							
Cash and cash equivalents	1,676,299	1,796,811	1,956,811	2,090,486	2,230,742	2,370,998	2,511,254
Restricted cash and cash equivalents	11,324	18,733	30,542	39,418	49,027	58,636	68,245
Short-term investments	33,739	72,313	110,887	149,461	188,035	226,609	265,183
Accounts receivable	1,082,406	1,343,247	1,604,088	1,864,929	2,125,770	2,386,611	2,647,452
Income taxes receivable	13,805	19,402	24,999	30,596	36,193	41,790	47,387
Prepaid expenses and other current assets	158,688	199,745	240,802	281,859	322,916	363,973	405,030
Property and equipment, net	1,064,259	1,394,904	1,725,549	2,056,194	2,386,839	2,717,484	3,048,129
Long-term investments and other assets	642,802	520,058	520,058	520,058	520,058	520,058	520,058
Deferred income taxes	15,458	23,658	31,858	40,058	48,258	56,458	64,658
Intangible assets, net	2,793,954	2,446,652	2,446,652	2,446,652	2,446,652	2,446,652	2,446,652
Goodwill	7,992,941	7,942,023	7,942,023	7,942,023	7,942,023	7,942,023	7,942,023
Liabilities							
Accounts payable, merchant	1,329,870	1,509,313	1,688,756	1,868,199	2,047,642	2,227,085	2,406,528
Accounts payable, other	485,557	577,012	668,467	759,922	851,377	942,832	1,034,287
Deferred merchant bookings	2,337,037	2,617,791	2,898,545	3,179,299	3,460,053	3,740,807	4,021,561
Deferred revenue	235,809	282,517	329,225	375,933	422,641	469,349	516,057
Income taxes payable	68,019	49,739	49,739	49,739	49,739	49,739	49,739
Accrued expenses and other current liabilities	1,469,725	1,090,826	1,090,826	1,090,826	1,090,826	1,090,826	1,090,826
Long-term debt	3,183,140	3,159,336	3,159,336	3,159,336	3,159,336	3,159,336	3,159,336
Deferred income taxes	473,841	484,970	484,970	484,970	484,970	484,970	484,970
Other long-term liabilities	314,432	312,939	311,446	309,953	308,460	306,967	305,474