

<https://www.theglobeandmail.com/investing/investment-ideas/article-why-booking-holdings-is-a-smart-pick-for-investors/>

 WATCHLIST

THE GLOBE AND MAIL 

Why Booking Holdings is a smart pick for investors

MICHAEL MCCLOSKEY
THE GLOBE AND MAIL
PUBLISHED MAY 22, 2019

In an aging bull market, undervalued stocks are difficult, but not impossible to find.

Take Booking Holdings Inc. ([BKNG-Q](#) +0.81%increase) – the largest online travel agency (OTA) in the world – for example. While that name may not be familiar to readers, we suspect you may have used one of their platforms in the past: Booking.com, Kayak, Priceline, Agoda, Rentalcars.com and OpenTable. Or perhaps you are more familiar with competitor Expedia Group Inc. ([EXPE-Q](#) +0.29%increase).

We believe the OTA industry is attractive because it benefits from two major secular trends that are likely to persist: rising global incomes and the migration of travel booking to online platforms.

The OTA industry has significantly consolidated over the past decade through multiple acquisitions by Booking Holdings and Expedia Group. The largest OTAs attract more travellers, which in turn attracts more travel suppliers. The reinforcing feedback loop of this network effect over many years led to a market structure whereby the dominant OTAs take most of the industry market share and profits. As a result, these two companies have emerged as a virtual duopoly outside of China.

Some hotels have complained about the high commissions charged by the OTAs (often 10 per cent to 20 per cent). Yet, they continue to provide their supply to the OTA platforms as their demand increases occupancy rates. Hotels operate largely fixed-cost businesses and higher occupancy significantly improves profitability.

We prefer an investment in Booking Holdings over Expedia Group. Booking Holdings is particularly strong in Europe where it began whereas Expedia Group's roots are in the United States. The European hotel industry has a much higher percentage of boutique hotels than the United States. Small hotels are generally less well staffed and have smaller marketing budgets, making them more reliant on OTAs to attract customers. We believe that the company's strength in the European market is a structural competitive advantage. By our calculations, Booking Holdings generates more operating profit and free cash flow than all other OTAs (including Expedia Group) combined.

At the current price of US\$1,744.96, the stock is trading at a below-market multiple (17.5 times earnings) 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.

Given the high quality of the business and growth prospects, we believe that the business is worth at least 20 times earnings. Adding in the company's cash holdings and long-term investments, we believe the shares are worth at least US\$2,300, an almost 32-percent premium to the stock's closing price Wednesday.

The biggest risk to an investment in Booking Holdings is the emergence of a competitor that disrupts the OTA duopoly. We don't believe that a metasearch engine such as TripAdvisor Inc. or a social-media company such as Facebook Inc. can pull it off. But Alphabet Inc.'s Google makes us a little nervous.

However, Google's entry into the OTA market would place it into direct competition with two of its largest advertising customers. We estimate that Booking Holdings and Expedia Group spent US\$7.3-billion in advertising with Google last year.

We believe 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 advertising partners by qualifying those leads more fully through its travel-related offerings.

Considering this overhanging threat, Booking Holdings has increased its TV advertising to build up its consumer brand and the amount of direct traffic to its platforms. (Direct traffic accounts for more than half its business.) This shift in ad spending should help to gradually wean the company off their reliance on Google for traffic.

No one knows for certain how the industry will continue to evolve. But we believe that the risk-reward of an investment in Booking Holdings is attractive at current market prices. Just as any smart business traveller makes cancellable hotel reservations, we always reserve the right to change our minds as the future unfolds.

Disclosure: GreensKeeper and accounts managed by it may hold long equity positions of a profiled company and may from time to time trade in these securities.

Michael McCloskey is the founder & president of GreensKeeper Asset Management