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Priceline.com (NASDAQ: PCLN)

Alliance with Travelocity.com and Expansion to Foreign Markets

Rating: **ACCUMULATE**

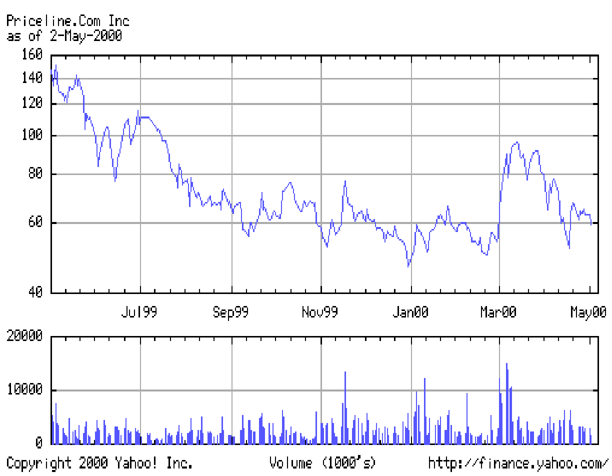
May 9, 2000

KEY CONSIDERATIONS

- Priceline reported a gross margin of 15.6% for the first quarter of 2000, the highest ever in its history.
- Priceline added 1.5 million new customers in the past quarter, bringing its total customer base to 5.3 million.
- Priceline added three new executive vice presidents to its management team.
- Priceline took initial steps to expand its consumer-driven business model to foreign markets.
- Priceline entered into a strategic marketing alliance with Travelocity.com.

Recent Price	$60.25
52WK Low	$45.50
52WK High	$165.00
P/E	N/M
P/Book	25.74
P/Sales	12.97
Market Capitalization	$10,759.84 mil
Shares Outstanding	170.12 mil
Float	22.10 mil
Daily Volume (3-month Average)	3.97 mil
EPS	
1998E	$-0.53
1999E	$-1.05
2000E	$-0.16
Current Ratio	5.40
Total Debt to Equity	0.00
LT Debt	0.00
Total Cash	$178.63 mil

ONE-YEAR PRICE AND VOLUME GRAPH



COMPANY PROFILE

Priceline.com employs an innovative demand-driven e-commerce system that allows consumers to name their own price on a variety of goods. Currently, Priceline allows consumers to name their own price on airline tickets, hotel reservations, new car purchases, home mortgages, used goods sold by consumers, and groceries. The company aims to bring consumers the lowest possible price by selling the excess inventory of its participating vendors and through adaptative marketing alliances with other companies (such marketing programs allow other merchants to target the Priceline customer base in exchange for increasing the customer's bid on certain items). While Priceline is currently reports high losses, the company expects to become profitable some time in 2001. Additional information about the company and its products can be obtained at its web site, www.priceline.com.

This report was prepared by Simit Patel and David R. Rivas, Ph.D.

THE COMPANY

The first quarter of 2000 marked a period of significant and crucial growth for Priceline.com. The company added 1.5 million customers, the largest customer increase in a single quarter for Priceline. A gross margin of 15.6% and an earnings per share of -.04 also marked new quarterly company records.

In accordance with its business plan, the company continued to expand its product line. In the past quarter, Priceline launched its "Perfect Yard Sale" – a consumer-to-consumer commerce center. The company now allows its customers to acquire mortgages in all of the 50 states, and new cars can now be purchased in 48 states. Moreover, the company revised its car rental service so that customers can now "name their own price" – just as they do with all other Priceline products.

More importantly, Priceline.com announced its entrance into foreign markets in this past quarter. Priceline entered markets in New Zealand and Australia with the assistance of a newly formed entity, MyPrice PTY Ltd ACN. In these new markets, the company will initially offer leisure airline tickets and intends to expand into other areas, including hotels, rental cars, financial services (including credit cards, loans and insurance), telecommunications and automotive sales. Upon consummation of the transactions, Priceline.com will license its business model to MyPrice and will receive an annual licensing payment from MyPrice.

Priceline also delved into the Asian marketplace. The company entered into an agreement in principle to form an alliance with Hutchison Whampoa Limited to introduce its buyer-driven e-commerce system to the 2.6 billion consumers in China (and Hong Kong), India, Taiwan, Indonesia, Singapore, Thailand, Korea, Malaysia, the Philippines, Vietnam and certain other Asian countries. Under the terms of the agreement in principle between Priceline.com and a subsidiary of Hutchison, upon execution of mutually acceptable definitive agreements, a new company will be created to launch and manage the Name Your Own Price(sm) service in Asia. The Company will license its business model to the newly created company and provide technology, marketing and operations support. Hutchison will contribute its strong brand and leverage its extensive customer base and retail network in Asia. The new company will pay priceline.com an annual licensing fee in respect of priceline.com's intellectual property and technology marketing and operation services fees.

Priceline also made significant additions to its management team. The company added three new executive vice presidents: James McGill, William Pike, and Heidi Miller. Dr. McGill formerly worked in the Information Technology department of Morgan Stanley Dean Witter. For Priceline, he will head the technology group of the Priceline WebHouse Club, the department that sells groceries. On the other hand, Mr. Pike and Dr. Miller will be in charge of financial planning, analysis, and investor relations for Priceline. Mr. Pike was formerly employed by Lehman Brothers and KPMG. In addition, Dr. Miller was rated by Fortune magazine as the second most powerful businesswoman in the United States.

INDUSTRY OUTLOOK AND COMPETITION

In the first fiscal quarter of 2000, Priceline.com was affected by two major occurrences: (1) volatile fluctuations in the stock market and (2) the sharp increase in oil prices. The market was particularly harsh towards technology and e-commerce corporations. As a result, Priceline's stock fluctuated between 52 and 92 dollars per share during the quarter. In order for Priceline to succeed, the Internet and technology sectors must progress forward and increase in size.

Surprisingly, the sharp increase in oil prices did not seem to decrease Priceline's airline ticket sales, car rentals, or new car sales. High gas prices, in conjunction with an anticipated bear market, caused speculation that the airline industry would suffer early on in 2000. Considering that 85% of Priceline's total gross revenue for the year ended 1999 was derived from airplane ticket sales, this was expected to hinder the company's progress. This was not the case. In fact, Priceline's overall revenue increased by 85% over the previous quarter.

In spite of the fact that Priceline participates in several extremely competitive sectors, the company still managed to increase its revenue and market share in each respective industry. In comparison to the fourth quarter of 1999, Priceline tripled its car sales and doubled the number of mortgages it issued. Moreover, its newly established marketing alliance with Travelocity.com will allow the company to compete more effectively in the airline, travel, and tourism industries. According to independent research, the two companies will share the largest user base in the Internet travel industry -- estimated at more than 22 million -- under the alliance. In combination, the brands have the largest awareness among Internet travel providers. In addition, Travelocity.com recently announced the completion of a planned merger with Previewtravel.com, under which the two companies will offer services through the Travelocity.com brand name. We expect that this marketing alliance will considerably enhance Priceline's strength in the airline industry.

While Priceline continues to expand its automobile service, the competition in the online car industry is rapidly becoming more intense. Autobytel, a publicly held company in the online car industry, recently announced its partnership with AutoTradeCenter.com. This partnership will allow Autobytel to assist consumers in trading in their old cars when buying a new automobile. According to a recent study conducted by NADA, approximately 40% of new cars sold in America are bought with a trade-in. As a result, we believe that this partnership will allow Autobytel to increase its customer base and gross revenue, and will thus adversely affect Priceline's attempt to increase its revenue derived from car sales.

In the mortgage, consumer-to-consumer, and grocery industries, the competitive landscape for Priceline essentially remains the same. Ebay, with over 10 million registered users, still has a clear dominance of the used product marketplace. The online mortgage industry continues to prosper, but Mortgage.com still has the largest market share. In the grocery industry, however, Priceline clearly has the largest market share and continues to acquire additional customers through its alliance with WebHouse Club.

STRATEGIES FOR GROWTH

Priceline's strategy for growth has essentially remained the same. The strategy entails horizontally expanding their product line, thus allowing them to increase their revenue, offer a wide variety of products and/or services, and build a loyal customer base. Thus far, this strategy appears to be successful; in the first quarter of 2000, Priceline had 830,000 repeat customers – a 500% increase over the first quarter of 1999 and a 72% increase over the fourth quarter of 1999. In the near future, the company plans to expand its product line to include leisure travel products such as cruises; time shares and vacation packages; pre-paid long distance and other telecommunications services; credit cards; discounts on gasoline; and automobile and personal insurance in addition to other financial services products.

The risks associated with Priceline's strategy appear to remain the same. Namely, these risks include the following:

- Priceline still depends upon the airline ticket sales for the majority of its revenue, and thus is dependent upon the well-being of the airline industry.
- Priceline is dependent upon the continued usage and increasing prominence of the Internet.
- Priceline is dependent upon maintaining patents that are crucial to the uniqueness of its business model. The company currently has four patents.
- Priceline is dependent upon the maintenance of key alliances it has established, and the ability to create new alliances in order to successfully expand its product line.

We believe that Priceline's strategy for growth is suitable and will ultimately lead the company towards profitability.

FINANCIALS

Gross Profit. We believe that Priceline's gross margin will continue to improve in the future. The company's revenues have increased dramatically over the last year, and the consistently increasing number of customers and repeat customers indicate that the company's business model and strategy for growth are operating as intended. Given Priceline's improving performance over the past quarter, we expect the company's gross margin to continue to improve significantly. Furthermore, we suspect that company may reach profitability as early as the final quarter of 2000.

Research & Development. Priceline's venture into foreign markets, expanding product line, and need to improve its computer systems in order to effectively cope with rapid growth lead us to believe that the company will spend a considerable amount of its funds towards product development and system enhancement. Still, we believe that gross revenue will increase at a faster rate; as a result the margin will decrease.

Sales & Marketing. Priceline is still in the midst of its first national advertising campaign. In addition, the company's expanding product line and entrance into foreign markets will cause the company to increase its marketing expenditures significantly. Still, we believe that gross revenue will increase at a faster rate, thus causing the marketing margin to decrease. We believe that the majority of the company's expenses will also have decreasing margins.

Net Income. Net income has been negative since Priceline's inception, but the company has continued to gradually approach profitability. We expect Priceline to be profitable by the end of 2001, or as early as the final quarter of 2000.

VALUATION

Investment Opinion

We believe that the numbers of the table below show that the Priceline's valuation (P/S) is currently fair considering its patented and successful business method, expected improvements in its gross margin and strong trends toward profitability. We therefore believe that Priceline is fairly valued relative to its relevant competitors. Furthermore, in spite of the rising prices of gasoline and increased competition, the company has managed to successfully expand and approach profitability. The significant increase in the size of the customer base – and the number of repeat customers – indicates that the company has a successful business model and is popular among consumers. As Priceline continues to expand its product line and increase its revenue and customer base, we believe that it will significantly increase its total gross revenue and market capitalization. For these reasons, we give Priceline.com an ACCUMULATE rating, as we believe that the stock should be bought in weakness under the current volatile market conditions.

Company (SYMBOL)	Price-to-Sales ratio (P/S)	Gross Margin (%)
Amazon.com (AMZN)	10	17
eBay (EBAY)	67	74
Egghead (EGGS)	1	5
Priceline.com (PCLN)	11	11

Income Statement (in $)	FY97	FY98A	FY99A	FY00E
Revenue				
Revenues	0	21,604,165.00	481,000,000	1,410,000,000
Cost of Revenues:				
Products Costs	0	22,335,750	427,951,680	1145000000
Supplier Warrant Costs	0	0	11,142,277	25,200,000
Total Cost of Revenues	0	22,335,750	439,093,957	1,170,200,000
Gross Profit	0	-731,585	41,906,043	239,800,000
Expenses				
Expenses:				
Supplier start-up warrant costs		0	98,389,011	52750000
Sales and Marketing		20,702,631	66,426,621	160000000
General and Administrative	513,000	18,458,259	20,851,954	44,000,000
Systems and business developr	2,000,000	10,619,679	10,603,048	27,000,000
Total Expenses	2,513,000	49,780,569	196,270,634	283,750,000
Operating Profit	-2,513,000	-50,512,154	-154,364,591	-43950000
Interest income, net	0	395,536	6,166,878	17000000
Net Profit	-2,513,000	-50,116,118	-148,197,713	-26950000
Earnings Per Share	0	-0.53	-1.05	-0.160416667
Weight Average Common Shares	N/A	81,720,566	139816683	168000000
Margin Analysis (% of revenue)				
Gross Margin	0	-3%	9%	17%
Sales & Marketing	0	96%	14%	11%
General & Administrative	0	85%	4%	3%
Research & Development	0	49%	2%	2%
Operating Margin	0	-234%	-32%	-3%
Net Margin	0	-232%	-31%	-2%
Growth				
Total Revenue	N/A	NM	2126%	193%
Gross Profit	N/A	NM	-5828%	472%
Operating Expense	N/A	1881%	294%	209%
Operating Income	N/A	-2110%	-406%	72%
Net Income	N/A	-2094%	-196%	-82%
Fully Diluted EPS	N/A	NM	98%	-85%