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Priceline.com (Nasdaq: PCLN)

Update: **Organizational restructuring and refined strategy to stay afloat in 2001**
HOLD

February 28, 2001

KEY CONSIDERATIONS

- In the last quarter of 2000, Priceline entered an organization-wide restructuring phase, characterized by a renewed focus on its core business, travel, a termination of its Webhouse Club subsidiary, and an interruption of plans to enter new markets.

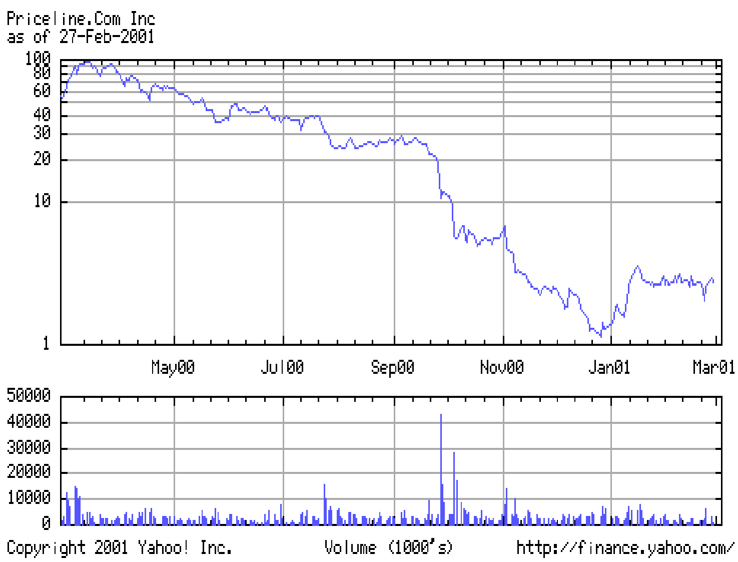
- Numerous difficulties have demolished Priceline's market value, among them, layoffs, departures of key executives, poor customer service, and bad press.

- Competition in the airline ticket sales industry is fiercer than ever, and the airline industry itself has faced troubled times.

- Priceline has won its lawsuit against Expedia, but is faced with class action suits initiated by investors.

Recent Price	$2.875
52WK Low	$1.063
52WK High	$104.25
P/E	N/M
P/Book	4.39
P/Sales	0.39
Market Capitalization	485.6 mil
Shares Outstanding	168.9 mil
Float	52.4 mil
Daily Volume (3-month Average)	2.83 mil
EPS	
1999	-$7.90
2000A	-$1.96
2001E	-$0.00
Current Ratio	1.55
Total Debt to Equity	0.00
LT Debt	0.00
Total Cash	$90.5 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, rental cars, new car purchases, home mortgages, travel insurance, and long distance phone minutes. The company aims to bring consumers the lowest possible price by selling the excess inventory of its participating vendors and through adaptive 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 currently reports high losses, the company expects its core travel business 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 Lucien Lidji, David R. Rivas, Ph.D. and Priya Mehrotra

THE COMPANY

Following the overall trend for e-commerce companies in the last quarter of 2000, Priceline's market value has fallen dramatically since its capitalization high of over $14 billion in March of last year to a sobering $450 million of late. The downward trend of the e-commerce sector in general only partially explains why Priceline's stock reached a low of $1.063 in late December, from its 52-week high of $104.25, despite a customer base increase to almost 9 million by year end.

In our view, several important events proper to the organization caused the severe decline. During the fourth quarter 2000, the company announced its intention to implement a number of measures to improve operations and reduce its overall cost structure. As part of the plans, the Company implemented a reduction in its work force of 168 employees, or 31% of its 538 employees. Additionally, the Company announced intentions to realign its operational management and eliminate operational redundancies, refocus its resources on its core travel products, strengthen its product offerings and international relationships, and implement a new compensation program to retain and motivate key employees. Costs associated with these turnaround plans amounted to $66.8 million in the fourth quarter 2000 alone, and will most certainly carry over into 2001 and continue to negatively impact earnings.

Furthermore, the Priceline WebHouse Club, Inc. and Priceline Perfect Yardsale, Inc., privately-held licensees of Priceline, which provided the online grocery and gasoline services of the Company, announced that they would be ceasing operations. The Company had received a warrant in WebHouse Club and wrote off its carrying value of $189 million in the third quarter of 2000. For the nine-month periods ended September 30, 2000, they had received royalties from WebHouse Club in the amount of $1.0 million. Costs associated with the overall impact of no longer providing certain services to WebHouse Club and Perfect Yardsale were reflected in a $37.3 million non-cash charge included in the charges aforementioned.

In November 2000, the Company announced that Heidi Miller, the Company's former Senior Executive Vice President and Chief Financial Officer, had decided to leave the Company. In connection with Ms. Miller's separation, the Company recorded a charge of approximately $3.3 million in the fourth quarter 2000, primarily as a result of the forgiveness of a loan pursuant to the terms of Ms. Miller's employment agreement. Ms. Miller, who had left her position as CFO of Citigroup to join Priceline in February, is very highly respected in her field, and her departure cast a negative cloud over the company. Additionally, Priceline lost its VP of financial planning and investor relations, William Pike; its director of investor relations, Allison McEnerney; and, of all people, its vice chairman and founder, Jay S. Walker. These losses of key employees are indicative of serious internal difficulties and underline the need for organizational restructuring.

Other events that caused the stock to drop include the amendment of the terms of warrants held by Delta Air Lines, Inc. As a result, the Company recorded a non-cash charge of $8.6 million in the fourth quarter 2000. In connection with the amendment, the Company reduced the number of shares underlying the warrant to 4.675 million shares from 5.5 million shares and reduced the strike price from $56.63 per share to $4.71875 per share.

The Company also blamed the airline industry, on which it is dependent for 85% of its revenues, for weakened ticket sales due to rising fuel costs, airline ticket surcharges, numerous flight cancellations due to the weather and to strikes, and airlines' own deep discounts. Fourth quarter airline ticket sales were Priceline's slowest, despite heavy holiday travel, and estimates for its earnings have been adjusted accordingly.

Furthermore, Priceline is facing numerous class action lawsuits, which allege that it violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, by issuing a series of material misrepresentations to the market. It is alleged that the Company's financial statements were materially false and misleading because the Company's financial results were materially inflated due to the inclusion of warrants to purchase WebHouse stock as assets and that when Priceline announced in October that WebHouse would terminate operations, Priceline's WebHouse warrants were rendered virtually worthless. These lawsuits are added to the list of other lawsuits the Company must presently manage, namely against Marketel International Inc., which alleges that it is the inventor of U.S. patent 5,794,207, on which Priceline's business model is based; Pannell-Christ Inc., which alleges infringement of its own "Name Your Price!" trademark; and, Walker Digital (the company which patented the "Name-Your-Own-Price" business model), which will not fulfill its obligations and cause Priceline an undisclosed charge in the fourth quarter 2000. On the upside, Priceline won its lawsuit against Microsoft and its majority-owned online travel company Expedia Inc., a major competitor, which will continue to offer its own price-matching service but will pay a royalty fee to Priceline. Fees and litigation expenses for these lawsuits will undoubtedly cause net earnings to fall accordingly.

Customer service issues were extremely detrimental to Priceline in the second half of 2000, when several television newsmagazines broadcast bruising segments on Priceline's shortcomings, highlighting the site's "crummy customer service." Customer complaints were higher than ever, leading to Connecticut's Better Business Bureau to remove Priceline from its roster. Priceline responded by hiring nationally known consumer advocate Robert Abrams as a consultant, and the Company was subsequently reinstated.

INDUSTRY OUTLOOK AND COMPETITION

Priceline is keeping its sights on sustaining its core business, airline ticket sales. Priceline.com sold over 4.63 million leisure airline tickets in 2000, but airline ticket sale revenues in the fourth quarter, albeit a seasonally weak quarter for Priceline, were especially disappointing, increasing by only 14% when compared to the same quarter in 1999. These disappointing results are due in part to the bad press the Company received, but also to the competition, which has become fierce. Although Priceline, has one of the most recognized names in e-commerce, the Company has competition in its online airline ticket sales and rental car businesses from Microsoft's Expedia, which now pays royalties to Priceline; Hotwire, to and from which a number of national and international airlines have agreed to participate in and receive an equity stake; Cheaptickets.com, an online consolidator; Travelocity.com and Lowestfare.com; all of which offer substantially the same travel products and services as Priceline. These are in addition to traditional travel agencies and sellers of the products, and groups of airlines, hotels, rental car companies, cruise operators and other travel service providers and operators of travel industry reservation databases such as Worldspan and Sabre. Finally, new competitors can launch new sites at a relatively low cost, such as Orbitz.com, in which airlines have also invested directly.

With respect to the arrangement and sale of new automobiles in the online marketplace, competitors include, Auto-by-Tel, Carsdirect.com, Autoweb.com, Greenlight.com and CarPoint.com. To some extent, Priceline competes for new car shoppers' attention with retail new car dealers, many of which offer online shopping capabilities.

With respect to financial service products, competitors include banks and other financial institutions; online and traditional mortgage and insurance brokers, including Quicken Mortgage, E-Loan and iOwn, Inc.; and, insurance companies.

Priceline's entrance into the long-distance phone market is not without risk either. Competition is equally intense and time will reveal whether the Name-Your-Own-Price model is functional in this area.

We believe that competition from these sources has had a material adverse effect on Priceline's business and financial condition but that it still may potentially compete successfully against current and future competitors, on the basis of the uniqueness of its model.

STRATEGIES FOR GROWTH

In order to reduce operating losses and improve gross margins, Priceline has significantly scaled down its ambitions to expand its scope of activities, choosing to aim for profitability in its core travel business to carefully select and further cultivate its alliances. Accordingly, the company inked a deal in November with a similar Internet reverse-auction site based in India called RazorFinish.com. Both companies said that they would begin a revenue-sharing program where Priceline would pay a commission to the Indian site for every sale it makes through Priceline. Also, it reached an agreement with Amadeus Global Travel Distribution (AMS Madrid) to use Amadeus' international Global Distribution System (GDS) to process ticket purchase requests from customers of priceline.com and its international licensees. Additionally, General Atlantic Partners, LLC recently invested an additional $25 million in Priceline Europe, bringing General Atlantic's total investment in the new company to $50 million and Priceline succeeded in strategically selling $50 million in common stock to its investment partners in Asia, Hutchison Whampoa Limited and Cheung Kong (Holdings) Limited.
Conversely, Priceline discontinued its discussions with Softbank E-Commerce Corp., a wholly owned subsidiary of SoftbankCorp. (Tokyo), to introduce Priceline's buyer-driven e-commerce platform to Japan. Planned entry into the Australian and New Zealand markets by Myprice Pty. Ltd., the Australian-based company created earlier this year to introduce Priceline's commerce platform to Australia and New Zealand were also aborted, as were plans with W. R. Berkley Corporation to create a new company to sell auto insurance over the Internet.
Finally, Priceline began selling long distance service through its alliance with ZeroPlus at the end of 2000, ahead of its anticipated February 2001 entry date.

RISKS

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 and its ability to maintain a significant market share. The growth of Hotwire and Orbitz increases the likelihood of this risk becoming a reality.

- 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. Priceline is aggressively protecting its patents; this is evidenced by the company's rightful patent infringement lawsuit against Expedia, a key competitor.

- 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, despite recent difficulties in establishing and/or maintaining such alliances.

FINANCIALS

Gross Profit. We believe that Priceline's gross margin will continue to improve in the future, despite increased competition. For the twelve months ended December 31, 2000, gross profit increased 226% over the same period in 1999 as a result of increased transactional sales volume, increased Worldspan reservation booking and customer processing fee revenues, and increased other fee-based revenues. In addition to increasing transactional volume, Priceline has also increased the average margin on air tickets and hotel rooms as compared to the same periods of 1999. Because fee-based revenues do not involve separate costs, these revenues have had a disproportionately positive impact on total gross profit. Fee-based revenues represented approximately 50% and 76% of total gross profit for the nine months ended September 30, 2000 and 1999, respectively.

Systems and Business Development. Systems and business development expenses rose due to increased staffing requirements and resulting consulting, payroll and overhead costs related to the expansion of the product offerings and technological infrastructure. In addition, the Company recognized increased depreciation and amortization expenses resulting primarily from capital expenditures and increased internal software development costs incurred in past and current quarters. However, because the Company is scaling back its entry into new markets and new regions, we believe costs will increase at a much slower rate than before.

Sales & Marketing. Priceline is continuing with a new national advertising campaign. Marketing expenditures growth has been dramatic, but can be expected to taper as brand recognition is relatively high and new customer acquisition has been positive. Also, since the company's cost of new customer acquisition is so low and bind rates have increased to over 45%, we believe that revenue will outgrow marketing expenses.

Net Income. Net income has been negative since Priceline's inception, but the company has refocused on achieving opertational profitability. As Priceline continues to expand its customer base at a rapid rate that is economically efficient, enjoys a large percentage of repeat customers, and offers a growing product line, we believe that profitability is a possibility. If it successfully fends off competition and no new undesired events occur, we can eventually expect Priceline to maybe turn a profit for the fiscal year 2001.

VALUATION

Investment Opinion

As much as Priceline stock was disproportionately overvalued back in March of last year, so too do we stipulate the opposite now. Priceline has entered a restructuring phase since the fourth quarter 2000, and only time can tell whether the aforementioned steps taken to achieve profitability will have been the right ones. We can approximate that the stock's price could rebound somewhat, but considering Priceline's limited ability to develop new ventures at this point, the possibility of a full-fledged recession in the United States, the impending internet-company shakeout, and the unproven "Name-Your-Own-Price" business model, there is a serious risk the Company might fail.

For these reasons, we now give Priceline.com a HOLD rating.

Comparative Valuations of E-commerce Companies

Company (SYMBOL)	Price-to-Sales Ratio (P/S)	Gross Margin (%)
Expedia.com (EXPE)	2.82	35.89
Travelocity.com (TVLY)	2.68	57.01
Cheaptickets.com (CTIX)	0.66	20.35
Autobytel.com (ABTL)	.72	100.00
Autoweb.com (AWEB)	.27	87.24
Priceline.com (PCLN)	.37	15.40
AVERAGE	1.25	52.65

INCOME STATEMENT	FY97A	FY98A	FY99A	FY00A	FY01E
Revenues					
Revenues	0	35,237,000	482,410,000	1,233,396,000	1,700,000,000
Cost of Revenues:					
Products Costs	0	33,496,000	423,056,000	1,041,704,000	1,392,476,000
Supplier Warrant Costs	0	3,029,000	1,523,000	1,524,000	1,524,000
Total Cost of Revenues	0	36,525,000	424,579,000	1,043,228,000	1,394,000,000
Gross Profit	0	-1,288,000	57,831,000	190,168,000	306,000,000
Expenses					
Expenses:					
Supplier start-up warrant costs	0	57,979,000	998,832,000	8,595,000	0
Sales and Marketing	441,000	24,388,000	79,577,000	148,133,000	187,000,000
General and Administrative	1,012,000	18,004,000	27,609,000	52,194,000	68,000,000
Systems and business development	1,060,000	11,132,000	14,023,000	39,192,000	51,000,000
Total Operating Expenses	2,513,000	111,503,000	1,120,041,000	248,114,000	306,000,000
Operating Loss	-2,513,000	-112,791,000	-1,062,210,000	-57,946,000	0
Interest income, net	0	548,000	7,501,000	9,687,000	10,000,000
Other income/expense	0	0	-381,000	-283,333,000	-400,000
Total Other Income	0	548,000	7,120,000	-273,646,000	9,600,000
Net Profit	-2,513,000	-112,243,000	-1,055,090,000	-331,592,000	9,600,000
Accretion on preferred stock	0	-2,183,000	-8,354,000	0	-10,000,000
Earnings Per Share	-0.05	-1.41	-7.90	-1.96	0.00
Common Shares Outstanding	50,834,000	81,231,000	134,622,000	168,898,000	200,000,000
Margin Analysis (% of revenue)					
Gross Margin	0	-4%	12%	15%	18%
Sales & Marketing	0	69%	16%	12%	11%
General & Administrative	0	51%	6%	4%	4%
Research & Development	0	32%	3%	3%	3%
Operating Margin	0	-320%	-220%	-5%	0%
Net Margin	0	-319%	-219%	-27%	1%
Growth					
Total Revenue	N/A	N/A	1269%	156%	38%
Gross Profit	N/A	N/A	4590%	229%	61%
Operating Expense	N/A	4337%	904%	-78%	23%
Operating Income	N/A	-4388%	-1042%	95%	100%
Net Income	N/A	-4366%	-840%	69%	103%
Fully Diluted EPS	N/A	NM	-461%	75%	100%