TripAdvisor: Collection of Misunderstood Platform Businesses Hidden in Plain Sight

tripadvisor®

Recommendation: Long

$35.03
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TripAdvisor: Introduction

Yes, we know you have heard TripAdvisor pitched multiple times over the past three years. You have heard pitches $30, $50, and even $70 "ago". You are probably thinking what new *this* write up could tell me about Instant Booking, CPC prices next quarter and Priceline's changes in its bidding strategy and a reallocation of its marketing budget toward non-performance based marketing channels. We will save the suspense here: we do not know the answers to those questions. Here is the good news: *we do not need to*.

Our thesis is straightforward. While everybody has been myopically focused on the challenges TripAdvisor has faced in its Hotel Business, over the past three and a half years the company quietly and with little fanfare has built two amazing platform businesses (*i.e.*, businesses that bring demand and supply together and benefit from a network effect) – Restaurants and Attractions. Both businesses operate in markets with winner-take-all dynamics, and TripAdvisor has emerged as the winner.

These platform businesses have been losing money because of heavy sales and marketing expenses necessary to build the networks for almost all of their existence and have thus received very little attention from the sellside analysts, who often do not even model the Non-Hotel Business separately. The buyside professionals have not paid much attention either. TripAdvisor itself has not helped by disclosing as little as possible about these businesses.

However, this is about to change as Restaurants and Attractions are on the verge of becoming massively profitable while continuing to grow their revenue. Vacation Rentals, the third Non-Hotel business, is already a solid profit contributor. LTM revenue of these three Non-Hotel Business businesses is ~$347M (less than 25% of total TripAdvisor's revenue) while LTM Adjusted EBITDA[1] is mere ~$38M which means ~11% margin. We expect that by 2022 revenue would increase ~2.5x while Adjusted EBITDA margins will reach 40% to 50% level (~$450M Adjusted EBITDA). The enterprise value of *entire* TripAdvisor is less than $4.4B today. We do not think that 2022 will be the year where the growth story ends since the Non-Hotel Business will be able to grow for many years beyond that. While the Non-Hotel Businesses' moat is already strong, it will get even stronger in a few years as their networks grow.

[1] The only profitability metric that TripAdvisor discloses for the Non-Hotel Business is Adjusted EBITDA. Thus, for comparability purposes we are using Adjusted EBITDA despite we generally dislike "adjusted" numbers.

This massive growth coupled with radical, breakthrough margin expansion may sound hard to believe. That's why we have included a case study of OpenTable and covered its history from 2004 until 2013. We believe that TripAdvisor Restaurants and TripAdvisor Attractions will repeat OpenTable's path from *negative* ~46% EBITDA margins to *positive* ~40% EBITDA margins while growing revenue 16x over the same period (2004 – 2013; North American business only).

Our OpenTable case study demonstrates how platform businesses develop, evolve and gain scale on the top line which leads to massive increases in profitability. We also explain the mechanics behind it by analyzing unit economics and increased usage by network members. TripAdvisor Restaurants is pretty much the same business in Europe as OpenTable is in North America. While TripAdvisor Attractions operates in a different vertical, the business dynamics are very similar as well.

TripAdvisor's Non-Hotel Business has shown the same tangible and clearly identifiable signs of inflection over the past three quarters that OpenTable showed *immediately* before its meteoric rise. By extrapolating evidence and patterns from OpenTable's past, we were able to build conviction about TripAdvisor's future.

We are convinced that most market participants do not appreciate the quality of businesses that TripAdvisor has been building and *at best* apply linear thinking to non-linear businesses. We have not seen anybody perform the type of analysis we have performed coupled with applying lessons from studying other platform businesses.

In our base case we view TripAdvisor shares as a double in 4 – 5 years even if the Hotel Business performs at the depressed levels of 2016 – 2017. On top of this, there is plenty of open-ended upside optionality that we are not paying anything for.

In our bull case, Restaurants and Attractions will be worth more in a few years than the entire TripAdvisor market cap today. In other words, in our bull case we would get TripAdvisor Hotel Business and Vacation Rentals for free.

We also think that Mr. Market will start paying more attention in late 2018 or 2019. By that time continuous increases in profitability of the Non-Hotel Business will become too hard to ignore. Furthermore, the Non-Hotel Business growing Adjusted EBITDA will make the entire company's Adjusted EBITDA start growing again in 2018 or 2019. We think at that time Mr. Market will start figuring out what it has been missing.

By investing in TripAdvisor shares:

- ✓ We are investing in dominant platform businesses hidden in a plain sight.
- ✓ We will benefit from a *multi-year* growth runway.
- ✓ We are getting the Hotel Business for (almost) free!
- ✓ We see upside of ~100% in 4 – 5 years and 15%+ IRR with plenty of open-ended upside optionality that we are paying zero for.

This investment memorandum may seem long at first, but it is not. We have used lots of graphs, charts, and other visuals to make it flow and improve reader engagement. We think you will like it.

Table of Contents

Contents

I. Why Does This Opportunity / Mispricing Exist?

Multiple factors contribute to the mispricing of TripAdvisor shares.

1. <u>Myopic Focus on Challenges in Hotel Business</u>

Both sellside and buyside professionals are *myopically* focused on challenges that Hotel Business has faced. They are *obsessed* with the failed transition to Instant Booking, falling revenue per hotel shopper, and Priceline's reallocation of its marketing budget towards non-performance based channels as announced by Priceline management on 3Q 2017 Earnings Call and 2017-11-07 CEO Glenn Fogel speech at the RBC Capital Markets TMT Conference.

Those challenges and concerns are very real, and we are not dismissing them. However, these concerns have overshadowed the incredible platform businesses with winner-take-all dynamics that TripAdvisor has been quietly building over the past three and a half years.

2. <u>Investor Fatigue</u>

The investor fatigue with TripAdvisor shares is very real. Just look at this graph!

TRIP shares are down ~70% since their top in 2014, and one is hard pressed to find any investor who made money in TRIP shares on the long side over the past few years.

3. Tech Is Often Ignored by Many Traditional Value Investors

With TripAdvisor shares down by ~70% and close to its multi-year low, one would expect that value investors would be bottom fishing. However, we do not think many value investors are looking into TripAdvisor because traditional value investors often shy away from technology stocks and TripAdvisor is a technology company.

As a result, TripAdvisor is in no man's land: growth investors have left disappointed and value investors never came.

4. Limited Disclosure about Non-Hotel Businesses

TripAdvisor provides extremely limited disclosure about its Non-Hotel businesses which prevents them from shining. To fully appreciate the strength on Non-Hotel businesses an investor needs to look *intently* and *know what to look for in advance*. Not many people have done this, which is understandable.

5. Linear Thinking in Non-Linear Context

Linear thinking cannot apply to platforms – *i.e.*, businesses that bring together supply and demand and benefit from the network effect. Yet, we believe that most investors approach TripAdvisor with linear thinking. This mismatch is one of the biggest contributors to why TripAdvisor is misunderstood and undervalued.

II. Where Does Our Variant Perception Come From?

Let's assume that these mispricing factors indeed exist. The question becomes *why* ***we*** *figured out this out*. We believe there were several factors that helped us.

1. We Never Owned TripAdvisor Shares Prior to August 2017

We never invested in TripAdvisor before August 2017 when we established our initial positions. After TripAdvisor released its 3Q 2017 and Mr. Market did not like them (to put it mildly!), we *substantially* increased our position.

The lack of pre-August 2017 relationship with TripAdvisor allowed us to come with fresh eyes and evaluate the attractiveness of TRIP businesses relative to its share price. This was our advantage over many other prior shareholders of TripAdvisor who lost substantial amounts of money over the past few years.

2. <u>Knowledge of Platform Businesses</u>

We have spent lots of time studying platform businesses (*i.e.*, businesses that bring together supply and demand and benefit from the network effect) and we know how poorly their financials look *at the beginning* and how lucrative such businesses become *once they scale*.

Our initial hypothesis was that ***TripAdvisor has a few platform businesses hidden within it***. So ***we knew what to look for <u>before</u> we started looking!***

3. <u>Non-Hotel Business Is the Core of Our Investment Thesis</u>

Only after we have combined our knowledge of platform businesses with studying what TripAdvisor has been doing over the past 3 – 4 years, we have realized what a gem TripAdvisor is!!! As a result, we base our investment thesis on Non-Hotel business while both the sellside and buyside are myopically focused on Hotel Business and the challenges it has experienced.

III. Capital Structure at a Glance

Below we provide a snapshot of TripAdvisor's capital structure.

F/D S/O, mln	139
Share price, $	$35.03
Market Cap, mln $	4,869
Debt, mln $	272
Cash, mln $	750
Short-term marketable securities, mln $	13
Long-term marketable securities, mln $	6
Casn and Cash Equivalents, mln $	769
EV, mln $	4,372

TripAdvisor's balance sheet is incredibly robust with substantial net cash position.

IV. What Does TripAdvisor Do?

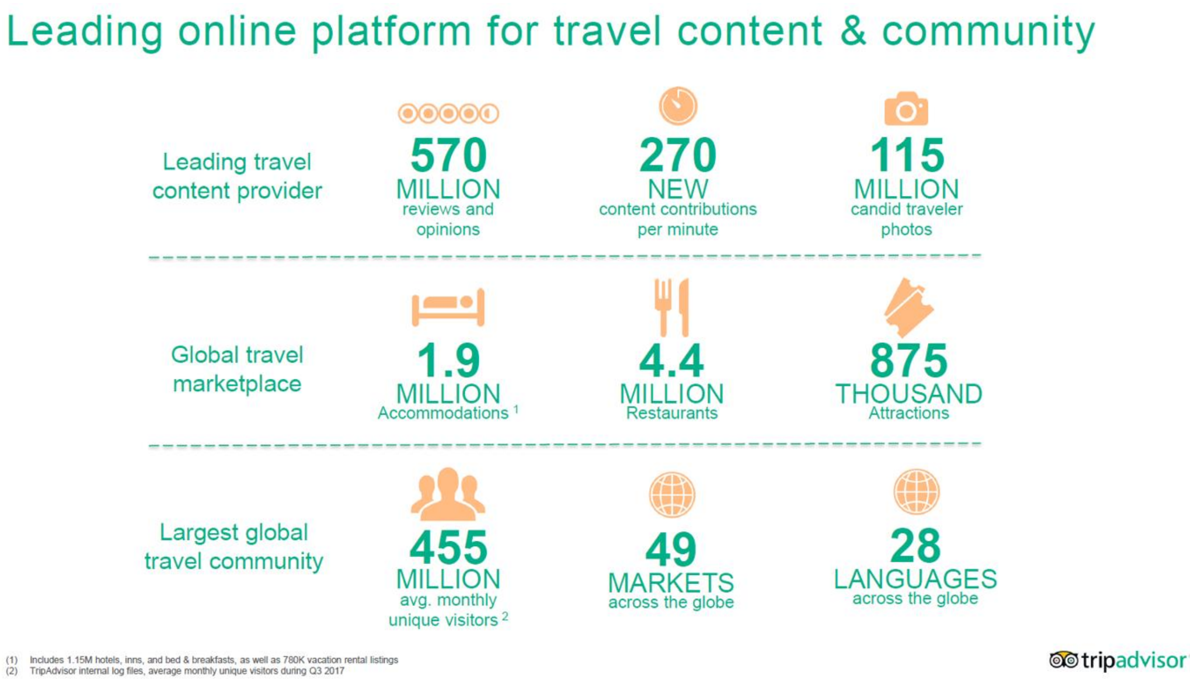
Our readers are most likely well familiar with TripAdvisor and its product and services. Hence, we will describe its business only briefly.

TripAdvisor offers a website and an app where users can read and post reviews about hotels, restaurants, attractions (museums, palaces, castles, tours, etc.), and vacation rentals. TripAdvisor features *user-created content* which means that TripAdvisor itself spends next to nothing to develop the content: it simply provides a platform and infrastructure for its users to share their reviews.

TripAdvisor benefits from a ***strong network effect*** and a ***virtuous cycle***. If you want to *read* reviews when choosing a hotel, you would go to the TripAdvisor website or app because this is where people have posted their reviews and will likely keep posting them. The same logic applies if you want to *post* a review: why would you post a review on a website other than the one with most viewership (*i.e.*, TripAdvisor)?

In addition, users can compare hotel prices and book hotels, vacation rental properties, attraction, and restaurants on www.tripadvisor.com and through the app.

TripAdvisor summarizes key statistics about itself well in its quarterly presentations:



Source: 3Q 2017 TripAdvisor Presentation.

V. TripAdvisor Reporting Segments

TripAdvisor has two reporting segments:

(1) Segment #1: Hotel Business
(2) Segment #2: Non-Hotel Business.

Importantly, the Non-Hotel Business includes **three sub-segments**:

a. Subsegment #2.1: Restaurants
b. Subsegment #2.2: Attractions
c. Subsegment #2.3: Vacation Rentals

TripAdvisor discloses revenue and Adjusted EBITDA (*i.e.*, EBITDA plus stock-based compensation ("SBC")) for each of its two segments – Hotel and Non-Hotel – since 2014.

However, TripAdvisor discloses ***no financial metrics for subsegments within the Non-Hotel Business***: Restaurants, Attractions, and Vacation Rentals. This makes conducting deep analysis more difficult and, as we mentioned before, contributes to mispricing.

VI. Historical Case Study: OpenTable

1. Why Do We Want to Introduce a Historical Case Study of OpenTable?

Before we dive into TripAdvisor and evaluate platform businesses that it has been building, we would like to go back in history and share a case study of OpenTable.

OpenTable®

There are a few reasons why we want to do this.

First, OpenTable is a platform business and studying it has helped us develop a better understanding and appreciation of how companies build platform businesses and how financial characteristics of such platform businesses evolve over time. This background knowledge helped us identify TripAdivsor as a potentially attractive investment and later guided our research efforts which culminated in making an investment in TripAdvisor shares.

Second, OpenTable is extremely comparable to TripAdvisor Restaurants business: the similarities are simply striking!

2. <u>What Is OpenTable and How Will We Conduct Our Case Study?</u>

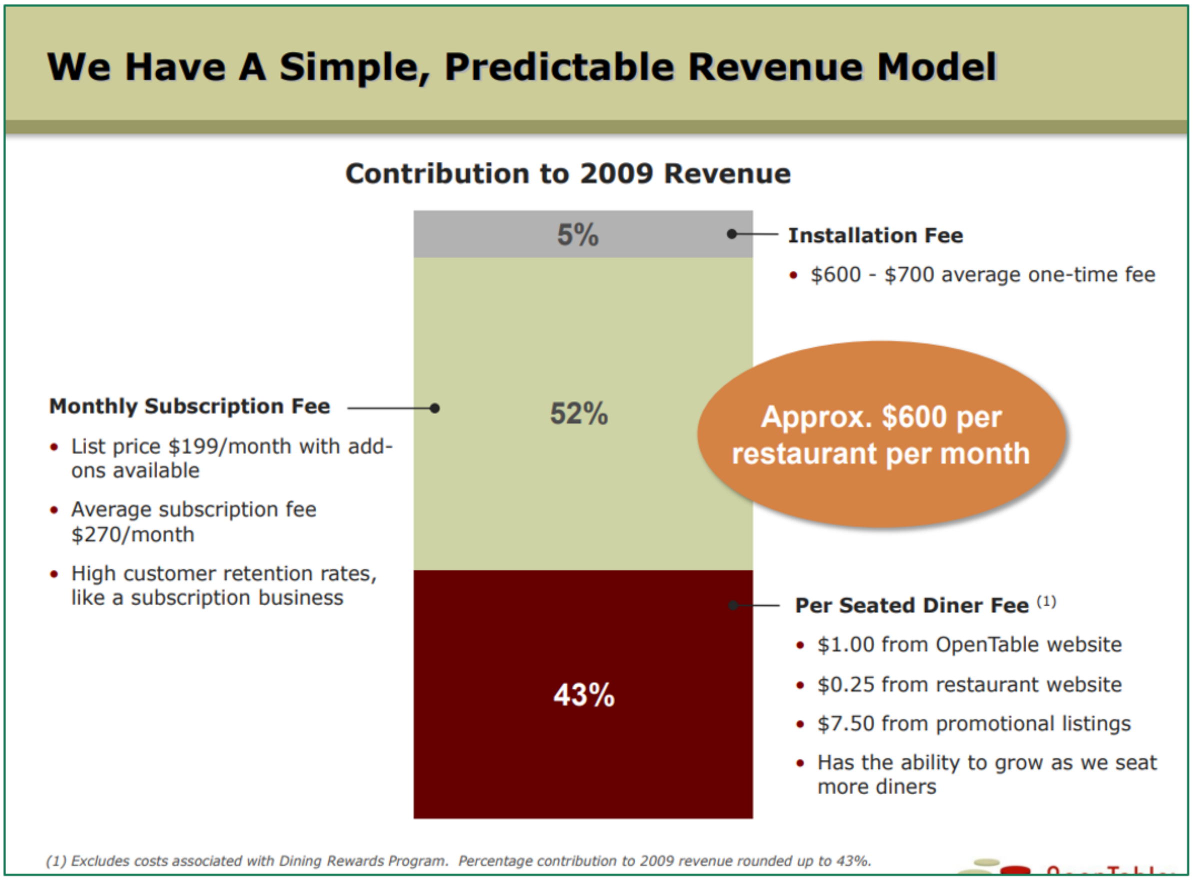
OpenTable probably needs little introduction as our readers have probably used the OpenTable website or app. We are avid users ourselves. Put simply, OpenTable brings together supply (restaurants' perishable inventory – *i.e.*, dinner tables on a particular night) and demand (diners) and enables diners to book a restaurant either on its website or via the OpenTable app.

OpenTable was launched in 1998 in San Francisco and went public in 2009. In 2014 Priceline acquired OpenTable (more on this below). OpenTable initially operated only in the United States but later expanded internationally.

To derive important lessons from a case study we need to follow a platform business from its early days to maturity / reaching scale. OpenTable's international business did not reach scale by the time when OpenTable was acquired and stopped reporting financial and operating data. As a result, we do not have a sufficiently long history and data for OpenTable's international business to do an insightful historical analysis. Thus, in our case study we will focus only on OpenTable's business in North America because it matured and reached scale. Analyzing it provides valuable lessons.

3. <u>How Did OpenTable Make Money?</u>

Let's go back to 2009 and see how OpenTable generated its revenue and earnings. This is how OpenTable answered this question in its investor presentation.



Source: OpenTable Corporate Presentation 2010 http://files.shareholder.com/downloads/ABEA-2TKK09/1013420981x0x393323/874d4f1c-9789-470e-8291-ddd314f29ecb/OpenTable%20Corporate%20Presentation%20August%202010%20FINAL.pdf.

OpenTable derived three revenue streams:

(1) Subscription revenue (~52% of total revenue in 2009).
(2) Reservations revenue (~43% of total revenue in 2009).
(3) Installation fees (~5% of total revenue in 2009).

(a) Subscription Revenue

Subscription revenue was ~52% of total revenue in 2009. Subscription revenue consisted of monthly subscription fees paid by restaurants. OpenTable charged restaurants a monthly subscription fee of $199 and offered various additional features. Given its success with upselling features, the average subscription fee per month was ~$270.

To grow its subscription revenue OpenTable had three options: (1) raise prices, (2) sign up more customers, and (3) come up with more features and upsell them to its customers. Not surprisingly, signing up more customers was the most logical and straightforward way to increase subscription revenue. However, it had two disadvantages: (1) it required investments in sales and marketing and (2) at some point OpenTable could run out of restaurants that would benefit from being on its platform. Thus, *subscription revenue stream had somewhat limited scalability*.

(b) Reservations Revenue

The second revenue stream is reservations revenue which was ~43% of total revenue in 2009. Reservations revenue consisted of seated diner fees that OpenTable charged restaurants $1 per person who ate there. So if you made a reservation for a party of four, then OpenTable would charge a restaurant where you had dinner $4.

As you can see, this was a ***variable revenue stream***, and as adoption of OpenTable grew, OpenTable would grow this revenue stream *without* signing up any more restaurants and without coming up with any new features. In other words, this revenue stream was ***extremely scalable*** and required very little incremental costs (if any) to grow.

Back in 2009 it was logical to expect that reservations revenue would outgrow subscription revenue over the next few years.

(c) Installation Fees

Installation fees were revenue stream #3 which constituted ~5% of total revenue in 2009. These fees were one time in nature and as a result were least important for growth of OpenTable.

4. <u>Key Metrics and Growth Drivers</u>

Modeling and projecting top line of OpenTable should have been fairly straightforward (at least in theory) because key metrics were very clear.

(1) Number of restaurants on the platform.

(2) Monthly subscription fee that OpenTable was charging restaurants.
(3) Number of seated diners – either in total or per restaurant.
(4) Fee per seated diner.
(5) Installation fees.

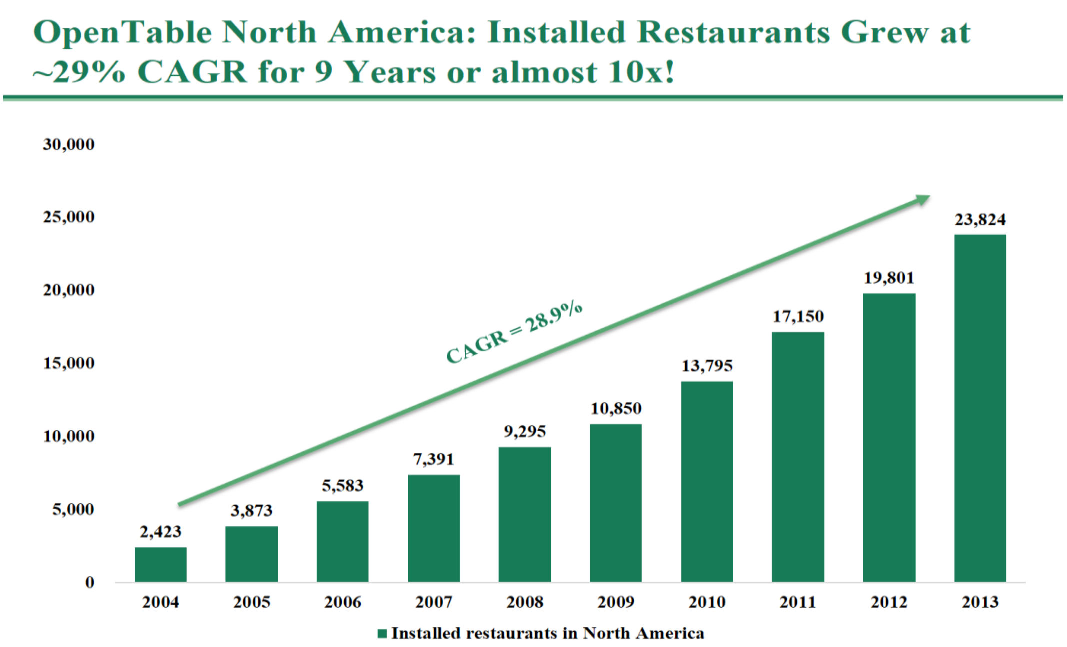
As you can see, the *key* variable metrics are number of restaurants on the platform and seated diners.

* * *

Now we can review how OpenTable performed operationally and financially over its history. We have data going back to 2004 since OpenTable went public in 2009. Our data ends in 2013 because Priceline acquired OpenTable in 1H 2014 and stopped disclosing OpenTable key metrics. Still, we have a long history that allows us to do a good historical analysis.

5. <u>OpenTable North America Grew Installed Restaurants 10x over 9 Years (~29% CAGR)</u>

This is how OpenTable grew its installed restaurants in North America:



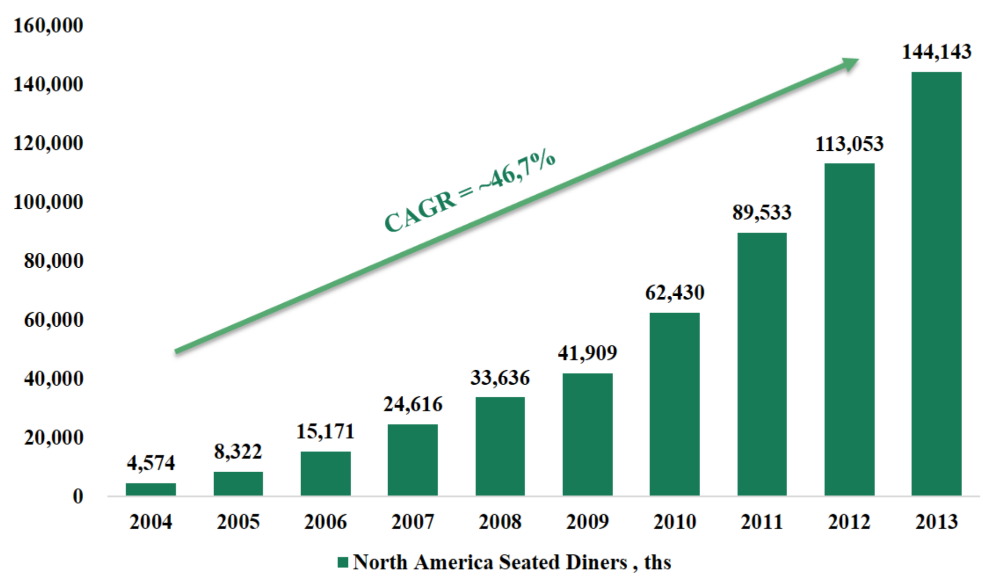
Source: OpenTable filings, Caro-Kann Capital research.

As you can see, installed restaurants grew ***almost 10x*** from 2004 to 2013.

6. <u>OpenTable North America Seated Diners Grew More Than 31x or 3x More Than Installed Restaurants</u>

If you think growth in installed restaurants was impressive, wait until we discuss growth in seated diners! Seated diners grew *more than 31x* over the same period which translates into mind-blowing CAGR of ~47%.

OpenTable North America: Seated Diners Grew Even Faster at ~47% CAGR Over 9 Years or more than 31x!



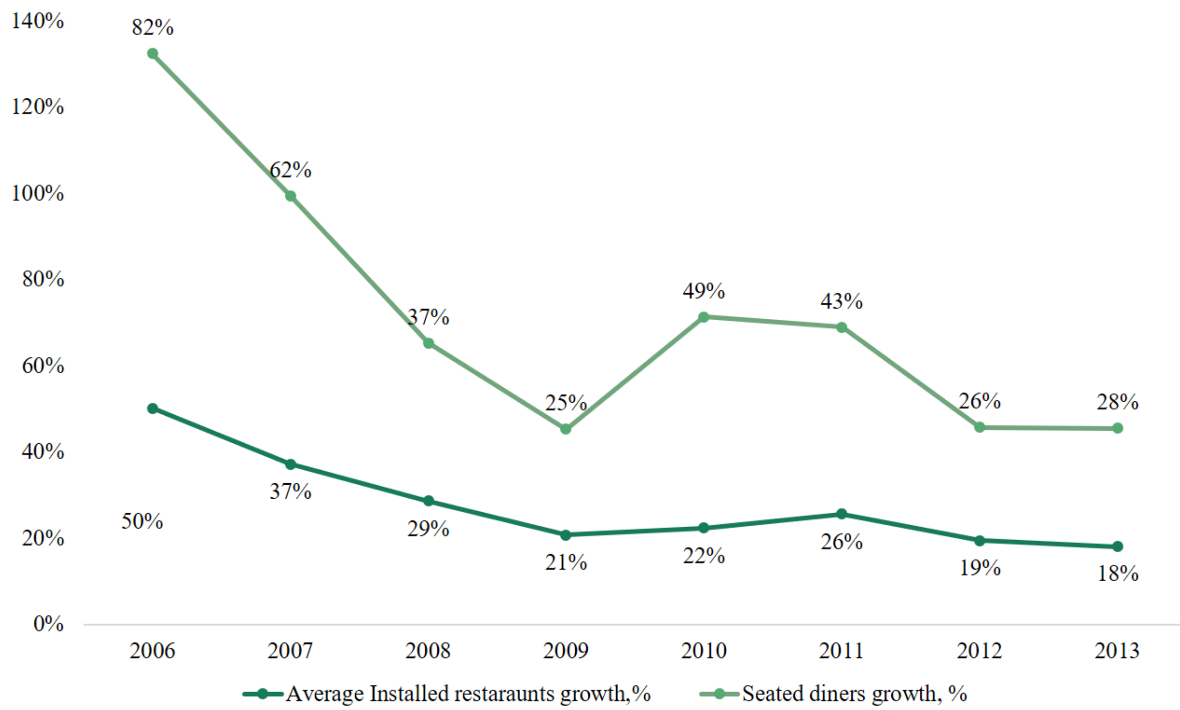
Source: OpenTable filings, Caro-Kann Capital research.

7. <u>OpenTable North America Average Installed Restaurants Growth vs. Seated Diners Growth</u>

To make comparisons between installed restaurants growth and seated diners growth more fair we will use growth in *average* installed restaurants. We lose a couple of years of data

(2004 – 2005) because we cannot calculate growth rates for those years, but our overall comparison will be more robust. The results are below:

OpenTable North America: Seated Diners Grew Faster than Average Installed Restaurants Grew in *Every* Single Year



Source: OpenTable filings, Caro-Kann Capital research.

Seated diners grew faster than average installed restaurants every single year!

8. <u>OpenTable North America: Seated Diners per Average Restaurant Grew 2.5x</u>

Two conclusions from the data above hold true:

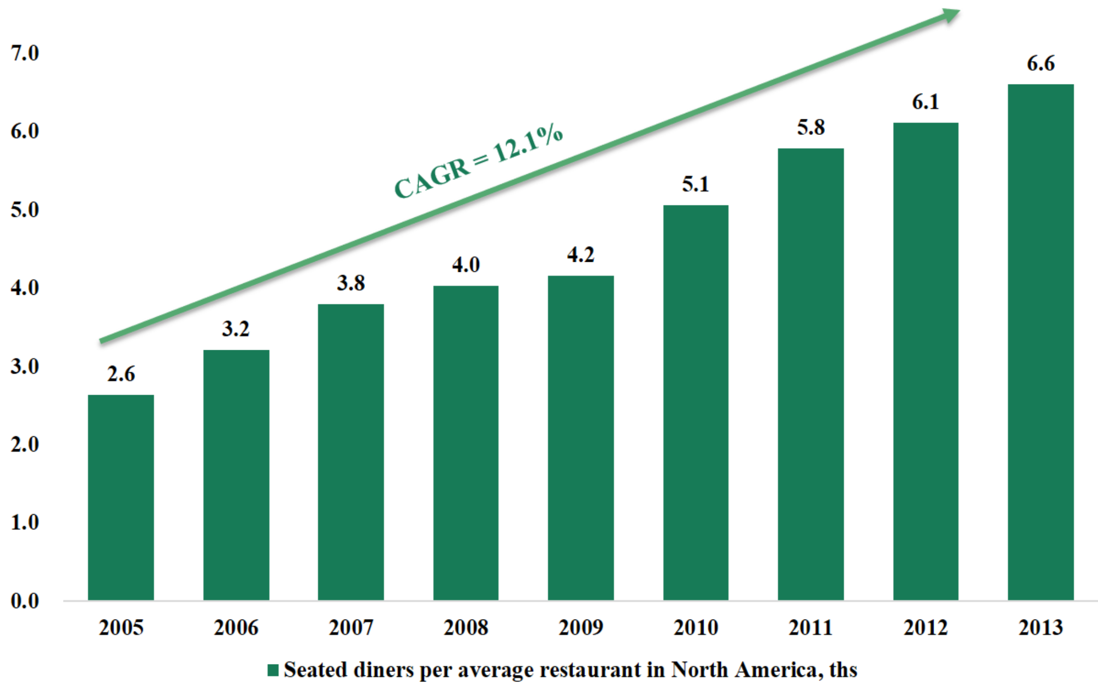
(1) A massive gap exists between growth in installed restaurants (~10x in 2004 – 2013) and growth in seated diners (more than 31x in 2004 – 2013).

(2) Seated diners grew faster than average installed restaurants in every single year in 2006 – 2013.

Mathematically, this means only one thing: ***seated diners per restaurant increased close to ~3x over the same period of 10 years***.

Indeed, seated diners per average restaurants grew ~2.5x over 2005 – 2013 period (please note that if we were using 2004 – 2013 period and installed restaurants at the end of the period as opposed to the average installed restaurants, the growth factor would be ~3x).

OpenTable North America: Seated Diners per Average Restaurant Grew at ~12% CAGR for 8 years or 2.5x!



Source: OpenTable filings, Caro-Kann Capital research.

9. <u>What Does Growth of 2.5x in Seated Diners Per Average Restaurant Mean and How Should We Model a Platform Business?</u>

How should we interpret growth in seated diners per average restaurant at a CAGR of ~12.1% over 9 years? This is our answer.

User engagement on the OpenTable platform increased substantially as the platform grew. Put simply, ***with every new restaurant added to OpenTable's platform, restaurant goers were making online reservations more often at existing restaurants***.

We strongly believe that this dynamic is typical for all successful platform businesses benefiting from the network effect: ***as the network grows, the user engagement increases***.

This dynamic has ***critical implications for financial modelling*** of a platform business which is radically different from modeling a traditional, linear business.

Let's see how we typically model a linear business. We will stay with the restaurant theme. Let's further imagine that we are analyzing a restaurant chain that has an appealing concept and an attractive customer value proposition. Today the company has 200 restaurants.

How would we model revenue of such company 10 years out? First and most importantly we would estimate how many new units it would be able to open over the next 10 years. We would also model same store growth of a few percentage points per year that consists of price / ticket size growth and traffic growth. However, we would *not* model a substantial increase in the same store sales of 2x or 3x over 9 – 10 years (let alone traffic per restaurant!). There may have been one or two restaurant chains that successfully increased their revenue per restaurant 2x or even higher over a 10 year period but they are clearly exceptions, and their existence does not negate the broader point that we are making here.

The key point here is that ***when a restaurant chain opens more units, it does not make its existing units more attractive and does not radically increase the number of diners at existing restaurants***.

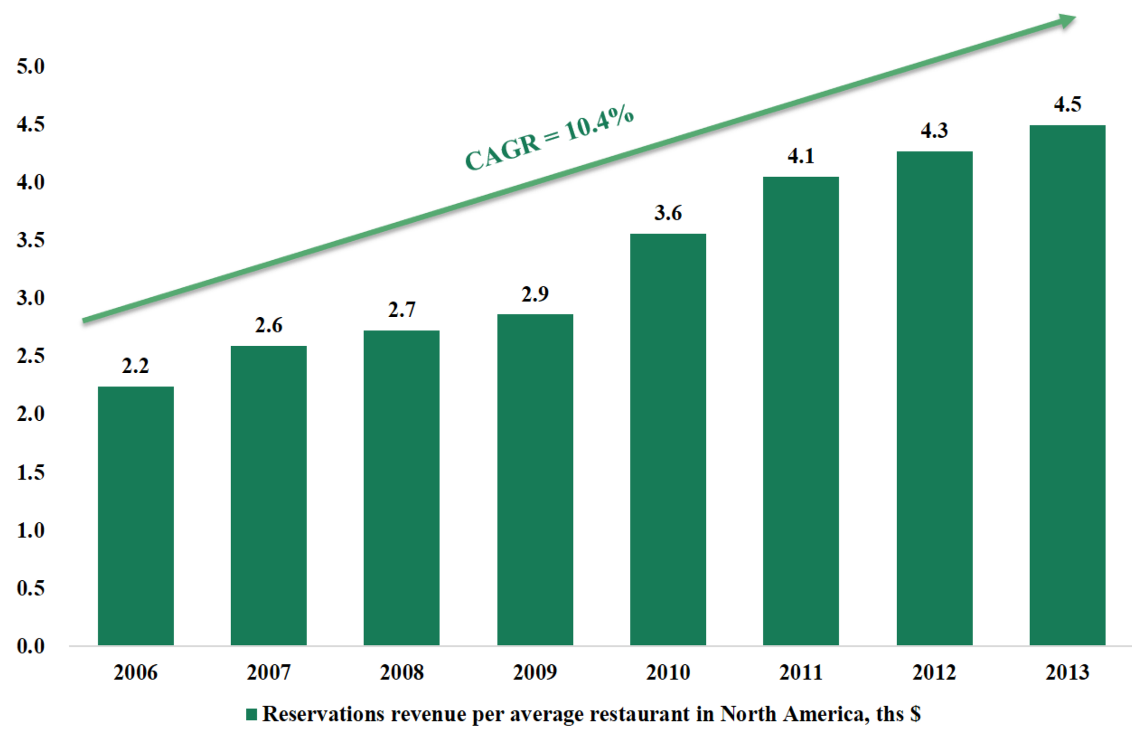
As we saw with OpenTable, ***the platform business works differently*** and as more and more restaurants joined the platform, ***the value of the platform and usage increased dramatically***. In addition, using the OpenTable website or app was ***habit forming***: after you made online reservations a few times, you would keep doing that! There is no attractive alternative unless you want to make your reservations the old-fashioned way – *i.e.*, by calling. As a result, ***as more restaurants joined the platform, OpenTable was able to facilitate more "transactions" between its existing restaurants and diners***.

The implications for financial modelling are ***paramount***. When we model a successful network business, ***we need to model not only the increase in active participants but also their increased engagement***. These two ingredients result in non-linear growth of platform businesses' revenue which is strikingly different from how we model linear businesses that grow linearly.

10. <u>OpenTable North America: Growth in Seated Diners Fueled Growth in Reservations Revenue per Average Restaurant that Grew at ~10.4% CAGR</u>

Increasing engagement on the platform and rapid growth in seated diners per average restaurant led to reservations revenue per average restaurant growing at ~10.4% CAGR in 2006 – 2013 or ~2x.

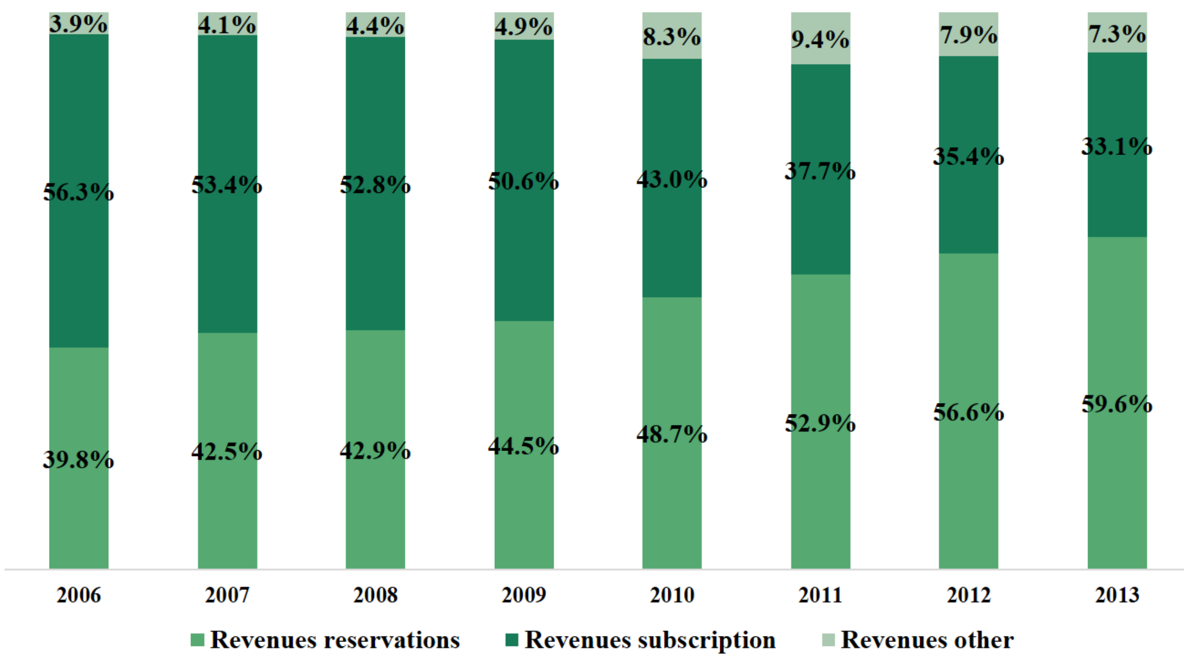
OpenTable North America: Reservations Revenue per Average Restaurant Grew at ~10.4% CAGR for 7 Years or 2x!



Source: OpenTable filings, Caro-Kann Capital research.

Growth in seated diners per average restaurant also led to revenue reservations becoming the largest revenue stream by 2010.

OpenTable North America: Reservations Revenue Grew as % of Total from Less than 40% to Almost 60%



Source: OpenTable filings, Caro-Kann Capital research.

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Now when we have analyzed how OpenTable grew its revenue and what that means for how we should think about modelling revenue growth for platform businesses, we can move to OpenTable's profitability evolution. Our goal is to learn from OpenTable's profitability evolution over the years and apply those lessons to other platform businesses.

11. OpenTable North America: How Profitability Evolved and What It Means for Profitability of Platform Businesses

OpenTable North American EBITDA margins evolved from ***negative ~46% to positive ~41% over the course of 10 years***. This is a **massive change of ~87 percentage points**. We will be hard pressed to find a traditional, linear business that has completed a similar transition.

What makes platform businesses so radically different from linear businesses as far as profitability evolution goes? The answer boils down to unit economics.

(a) Linear Business Profitability Evolution

A typical linear business can start making money from its early days. Maybe not from day #1 but definitely from the early days. This is because *each separate unit of a linear business already delivers value to its customers*. Think of a grocery store or a pizza place in your neighborhood. As soon as they open, you as a customer can derive value as long as their product offering is robust: a grocery store carries enough SKUs to satisfy your needs and pizza tastes great. You as a customer do not really care how many stores or pizza joints such company has nationwide or even in your state because those aspects have zero implications for your customer experience. This allows each particular unit to derive a profit from the early days. On top of that, the costs of running one pizza joint are commensurate with the revenue that such pizza joint can derive. Once a linear business grows and expands by opening more units, its profit margins improve somewhat but not radically because many costs are still variable and they will grow hand in hand with revenue.

(b) Platform Business Profitability Evolution

Platform businesses operate differently. In the early days the network is small, and the platform business can only bring very limited supply and very limited demand together. Thus, *it can deliver only limited value to its customers. As a result, it cannot monetize well*. At the same time the costs to operate the platform business are high even at the beginning when the number of network participants is small. Both revenue and costs of a platform business in the early days are radically different from revenue and costs of a linear business.

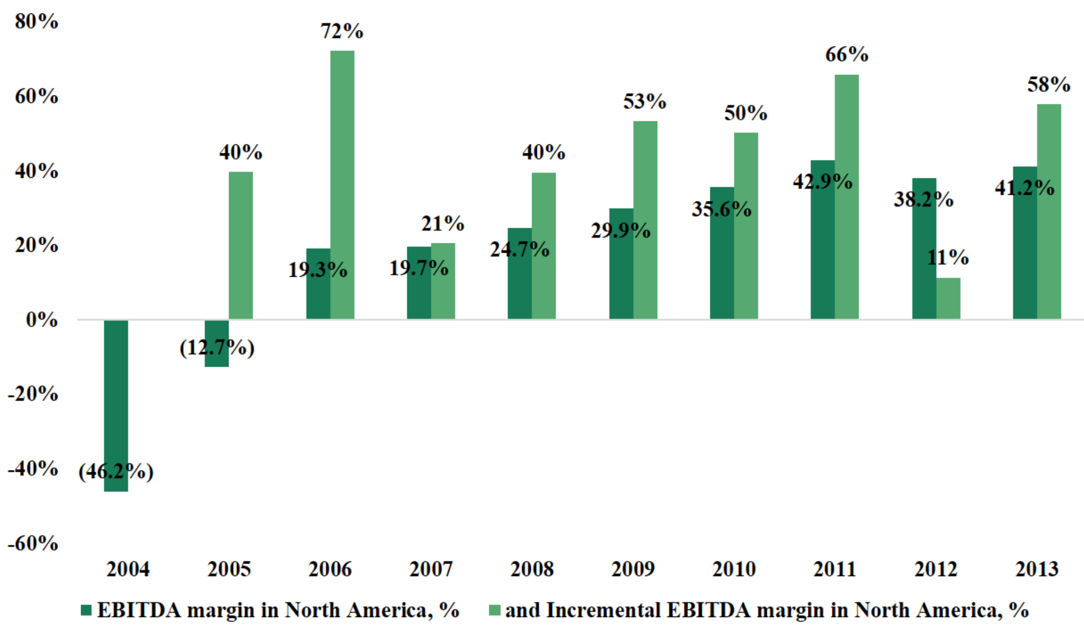
As the network grows, and the platform business brings more and more supply and demand together, its customer value proposition improves drastically. When this inflection point happens, the platform business can monetize well and as a result it becomes profitable. On top of this, once a platform business scales, *its costs grow significantly slower than revenue which results in rapid margin expansion. The costs grow significantly slower than revenue because most of the costs are fixed and variable costs are quite moderate*.

With this background, we can go back to OpenTable.

(c) OpenTable Profitability Evolution

Below we provide information about how EBITDA margins and incremental EBITDA margins of OpenTable changed in North America.

OpenTable North America: EBITDA Margins and Incremental EBITDA Margins – ALWAYS Watch for Incremental Margins



Source: OpenTable filings, Caro-Kann Capital research.

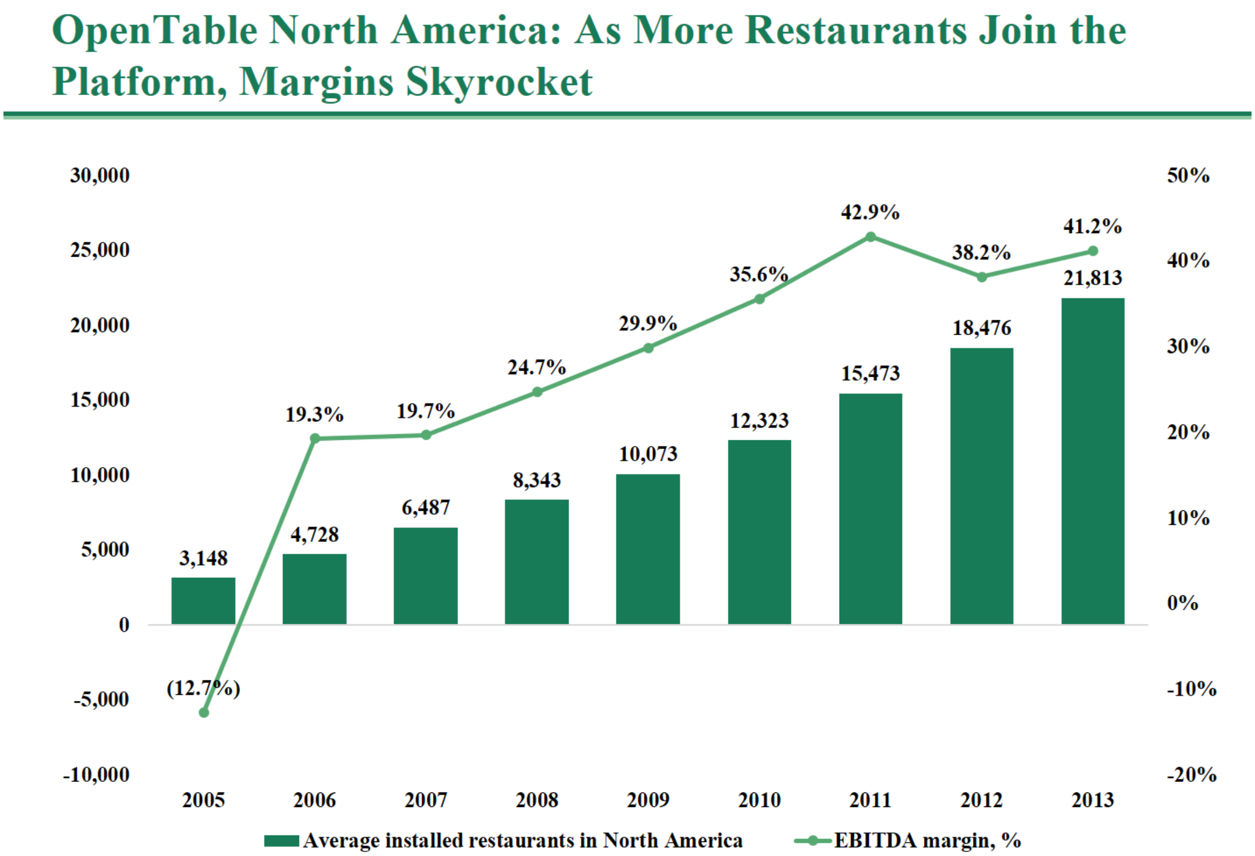
Incremental EBITDA margins are equal change in EBITDA divided by change in revenue. We use year-over-year changes. We cannot calculate incremental EBITDA margins for 2004 given lack of financial data for 2003.

These are main lessons from the EBITDA and incremental EBITDA margin analysis.

(1) Incremental EBITDA margins are massive and generally run at 40% to 50% and often even above that.
(2) Radical improvement in incremental EBITDA margins is the best leading indicator of a future significant improvement in EBITDA margins. Please refer to 2004 – 2005 time period. In 2005 EBITDA margins improved from negative ~46.2% to negative ~12.7% which is a substantial improvement. However, incremental EBITDA margins in 2005 were massively *positive* at 40%. That was a leading indicator of EBITDA margins turning positive soon, which indeed happened in 2006: EBITDA margins were ~19.3% driven by incremental EBITDA margins expanding to ~72%.
(3) Platform business' margins can improve very quickly.

Please remember these three takeaways as they will be critical for understanding TripAdvisor's platform businesses.

It is also interesting to see how EBITDA margins improved with growth in average installed restaurants.



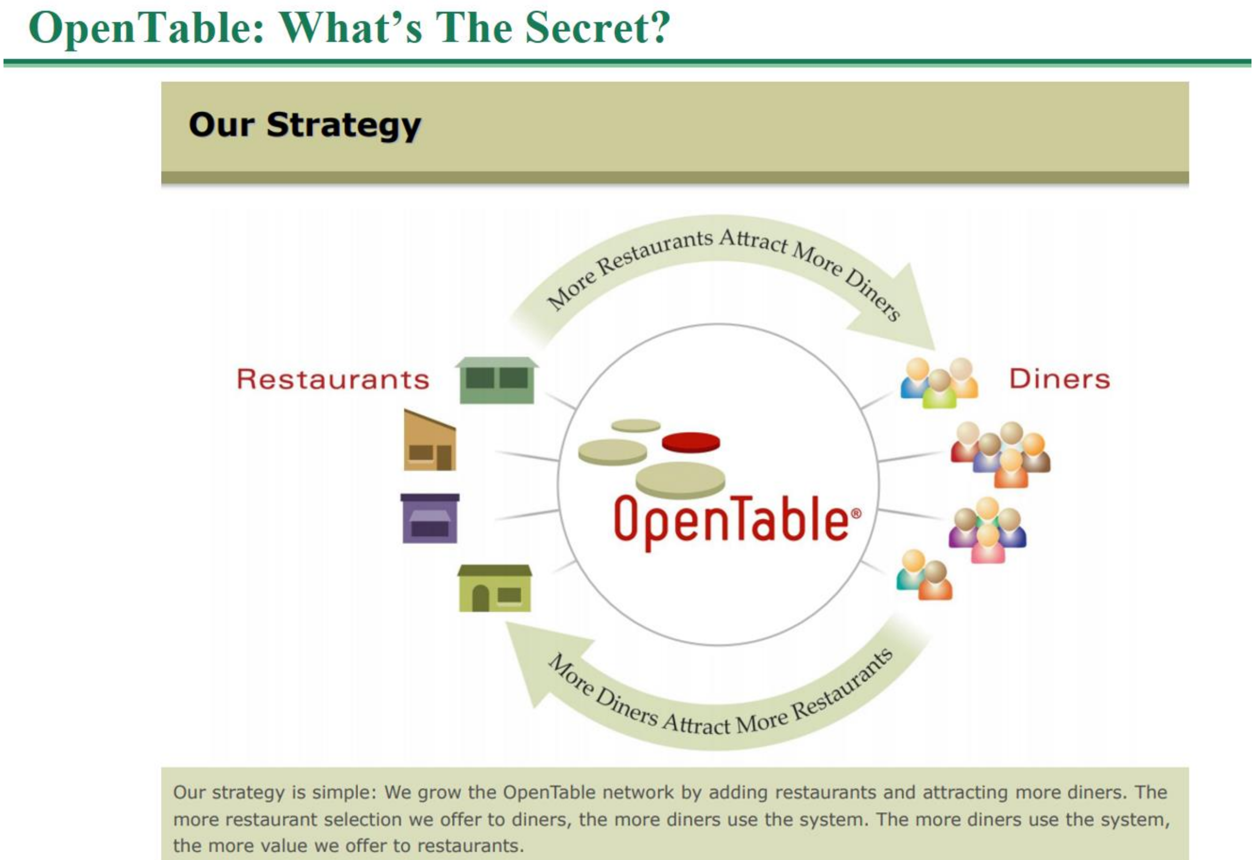
Source: OpenTable filings, Caro-Kann Capital research.

12. <u>OpenTable: What's The Secret?</u>

OpenTable's success as demonstrated by rapid revenue growth and a meteoric rise in EBITDA margins begs a question: ***what is behind such success and what is the secret recipe?***

The answer is simple: ***OpenTable successfully got the virtuous cycle going where more supply brings more demand, more demand brings more supply, and more supply brings more … lather, rinse, repeat***.

This is how OpenTable itself described it:



Source: OpenTable Corporate Presentation 2010 http://files.shareholder.com/downloads/ABEA-2TKK09/1013420981x0x393323/874d4f1c-9789-470e-8291-ddd314f29ecb/OpenTable%20Corporate%20Presentation%20August%202010%20FINAL.pdf.

Such a virtuous cycle is very hard to start but once it gains momentum, it becomes extremely powerful. On top of this, this type of business is a ***winner-take-all business*** which has a ***very strong moat*** and is very difficult to disrupt as any potential entrants would face a chicken-and-egg problem. This highly scalable business model allows businesses to rapidly grow revenue with very modest growth in costs, which results in extraordinary high incremental margins.

13. Priceline Acquired OpenTable at ~48.7x EV/EBITDA

In 2014 Priceline acquired OpenTable for ~$2.6B or ~$103 per share.

Below we provide a valuation of OpenTable immediately before the announcement and valuation at the time of the acquisition.

Valuation of OpenTable: Before Acquisition vs. Acquisition Price

	Before Announcement	After Announcement
Share price, $	70.4	103.0
F/D S/O, ths	23,443	26,121
Market Cap, $ ths	**1,651,090**	**2,690,460**
Cash, $ ths	$103,469	$103,469
Debt & Debt Equivalents, $ ths	0	0
Enterprise Value, $ ths	**1,547,621**	**2,586,991**
LTM Revenue, $ ths	**198,328**	
LTM EBITDA, $ ths	**53,085**	
Installed restaurants	**31,583**	
EV/LTM Revenue	**7.8x**	**13.0x**
EV/LTM EBITDA	**29.2x**	**48.7x**
EV/Installed restaurant, $ ths	**49.0**	**81.9**

Source: OpenTable filings, Priceline filings, Caro-Kann Capital research.

Priceline paid astonishing ~13x LTM revenue, ~48.7x LTM EBITDA and ~$82K per installed restaurant. Please note that these are companywide metrics as opposed to North American business only.

It is widely believed that Priceline wanted to fuel OpenTable's growth in Europe where Priceline has a very strong presence through www.booking.com.

14. Priceline Took Almost $1B Goodwill Impairment on OpenTable Acquisition

In 3Q 2016 Priceline recognized a massive, almost $1B goodwill impairment for its OpenTable acquisition. It was ~$940.7M to be precise. The impairment was taken just slightly more than two years after Priceline bought OpenTable.

This is what Priceline filings stated about the goodwill impairment:

> "The goodwill impairment is primarily the result of a change in OpenTable's business strategy that occurred during the third quarter of 2016."
>
> "…while OpenTable intends to continue to pursue and invest in international expansion and its other growth initiatives, it intends to do so in a more measured and deliberate manner"
>
> *Source: 2016 Priceline 10-K.*

Decoding the corporate language of the SEC filings, *OpenTable's international expansion strategy failed*.

Given such a large goodwill impairment, we would like to adjust OpenTable valuation for what Priceline *should* have paid for it – *i.e.*, acquisition price minus goodwill impairment.

OpenTable Valuation that Priceline ***Should Have*** Paid Given Subsequent Massive Goodwill Impairment

	Before Announcement	Actual transaction
Enterprise Value, $ ths	**1,547,621**	**2,586,991**
LTM Revenue, $ ths	198,328	
LTM EBITDA, $ ths	53,085	
Installed restaurants	31,583	
EV/LTM Revenue	7.8x	13.0x
EV/LTM EBITDA	29.2x	48.7x
EV/Installed restaurant, $ ths	49.0	81.9

	What PCLN should have paid (acquisition price minus goodwill impairment)
Goodwill Impairment in 2016, $ ths	940,700
EV that PCLN should have paid, $ ths	**1,646,291**
EV/LTM Revenue	8.3x
EV/LTM EBITDA	31.0x
EV/Installed restaurant, $ ths	52.1

Source: OpenTable filings, Priceline filings, Caro-Kann Capital research.

As you can see, Priceline should have paid pretty much the same price that OpenTable shares were trading at.

* * *

Now after we have completed a case study of OpenTable, we are ready to dive into TripAdvisor. OpenTable case study was fairly long, we promise that it will prove invaluable once we analyze and value TripAdvisor.

VII. TripAdvisor Restaurants: A Great Platform Business That Nobody Is Paying Attention To

1. Restaurants' History: Evolution from Review Pages with Next to Zero Monetization to a Major Platform Business

Before 2014 TripAdvisor had millions of restaurants reviewed on its website and millions of users were visiting those pages to find a place to eat while travelling. Customers loved it! However, TripAdvisor barely monetized this traffic.

In 2Q 2014 TripAdvisor acquired La Fourchette, which was a *game changer*. After that TripAdvisor created the "real" restaurant business with huge monetization potential.

2. What Was La Fourchette at the Time of the Acquisition?

At the time of the acquisition La Fourchette was an online reservation restaurant platform with ~12,000 bookable restaurants and a very strong presence in France and Spain. La Fourchette product was very similar to OpenTable's product.

TripAdvisor never disclosed the acquisition price.

Interestingly enough, TripAdvisor acquired La Fourchette around the same time when Priceline acquired OpenTable. Both Priceline and TripAdvisor had ambitions of conquering online restaurant reservations space in Europe.

This is what TripAdvisor management said about La Fourchette at that time.

> "La Fourchette has already achieved scale in these two large markets. They have shown they can operate at a profit while growing at a fast clip, and they are loved by their restaurant partners and diners alike."
>
> *Source: 1Q 2014 TripAdvisor Earnings Call.*

3. <u>TripAdvisor Management Clearly Outlined Its Expansion Strategy Once It Acquired La Fourchette</u>

Again it makes sense to go back in time and see what management said at the time of the acquisition about its strategy.

> "La Fourchette is growing rapidly, and TripAdvisor can help fuel even faster future growth by turning some portion of our incredible amount of global restaurant traffic into seated diners."
>
> *Source: 1Q 2014 TripAdvisor Earnings Call.*

TripAdvisor provided two critical ingredients to fuel La Fourchette's growth:

(1) Traffic and
(2) Growth capital.

TripAdvisor management had an ambitious vision for its Restaurants business:

> "I am thinking about building the restaurant business to be very meaningful for TripAdvisor over a three to five-plus year timeframe and that's going to take more than a quarter or two of investment dollars" (3Q 2014 TRIP Earnings Call)
>
> *Source: 1Q 2014 TripAdvisor Earnings Call.*

As you can see, management also warned that transforming La Fourchette into a major business within TripAdvisor *will take 3 to 5 years or even longer and will require investments* over a few years.

The core of the strategy was to expand into more international markets either organically or through tuck-on acquisitions. We believe that TripAdvisor management used buy vs. build logic in such situations. For example, TripAdvisor acquired Dimmi in 2Q 2015 to enter Australia.

4. Restaurants: Great Product and User Experience

TripAdvisor did not lose any time and improved the product fast after it acquired La Fourchette.

In 2Q 2014 restaurant goers could make reservations on La Fourchette website and via app. However, *in 3Q 2014 TripAdvisor launched its* **Instant Reservation feature** for restaurants on its own platform. In other words, visitors of www.tripadvisor.com gained ability to make reservations right on the website or through the app when they read restaurant reviews and found a restaurant at which they wished to dine. Needless to say, this is an amazing customer experience! Think about a typical use case here: you are in a foreign country, you do not speak the language, and you want to have a nice dinner. Your typical route is to go through a hotel concierge and trust their taste and recommendations. But what if you are staying at an Airbnb? Or what if you chose an inexpensive hostel? Now you can just rely on TripAdvisor for both research *and* reservations!

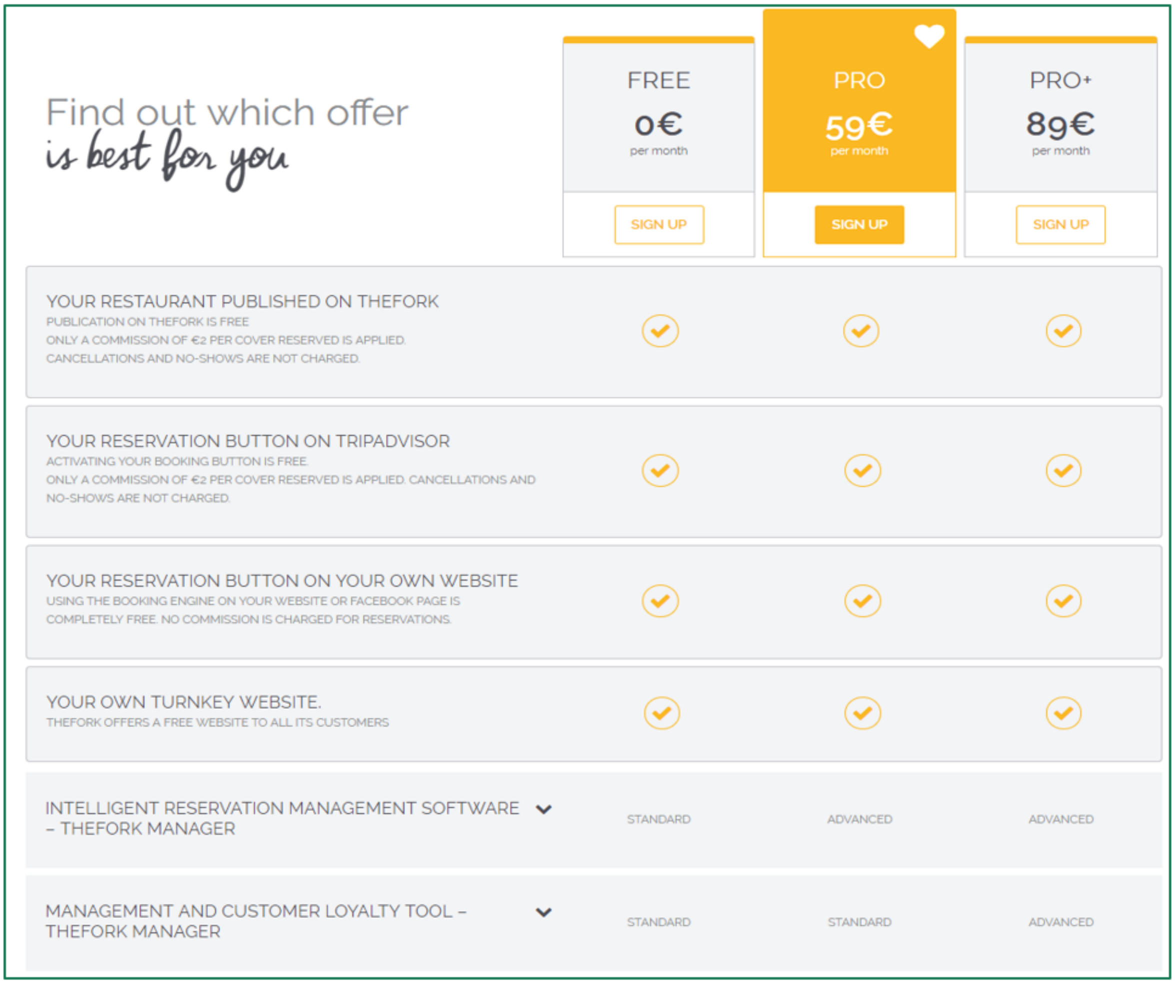
5. TripAdvisor Restaurants Business Serves Both Locals and Travelers

We also need to address a common misconception as some people believe that TripAdvisor Restaurants business serves only tourists. This is simply not true. TripAdvisor Restaurants business serves *both locals and travelers*. Travelers usually use www.tripadvisor.com or TripAdvisor app while locals use the La Fourchette website or app. In some countries locals will be using another website or app that is still owned by TripAdvisor Restaurants.

6. How Does TripAdvisor Restaurants Make Money?

TripAdvisor Restaurants makes money in a way that has striking similarities to how OpenTable makes money. Let's dive more into this.

Below is a screenshot from La Fourchette website that outlines a product / service offering for restaurants.



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MANAGEMENT AND CUSTOMER LOYALTY TOOL – THEFORK MANAGER	STANDARD	STANDARD	ADVANCED

Source: [*https://www.theforkmanager.com/prices/*](https://www.theforkmanager.com/prices/)

TripAdvisor Restaurants have two important revenue streams:

(1) Subscription revenue.
(2) Reservations revenue / seated diner fees.

(a) Subscription Revenue

Similar to OpenTable, TripAdvisor Restaurants charges monthly subscription fees to restaurants on its platform. It has three tiers of pricing: €0, €59, and €89. For discussion purposes we will use a current FX exchange rate of USD : EUR of 1.20.

We do not know the tier mix among restaurants on TripAdvisor platform because this has never been disclosed. For illustrative purposes we assume that ~55% of restaurants go with €0 pricing, ~35% of restaurants go with €59 offering, and remaining ~15% choose €89 plan. This brings the weighted average monthly subscription fee to ~€30 or $36 per month.

This compares very *unfavorably* to what OpenTable was charging back in 2009: $270 on average. This translates into a 7.5x difference.

(b) Reservations Revenue / Seated Diner Fees

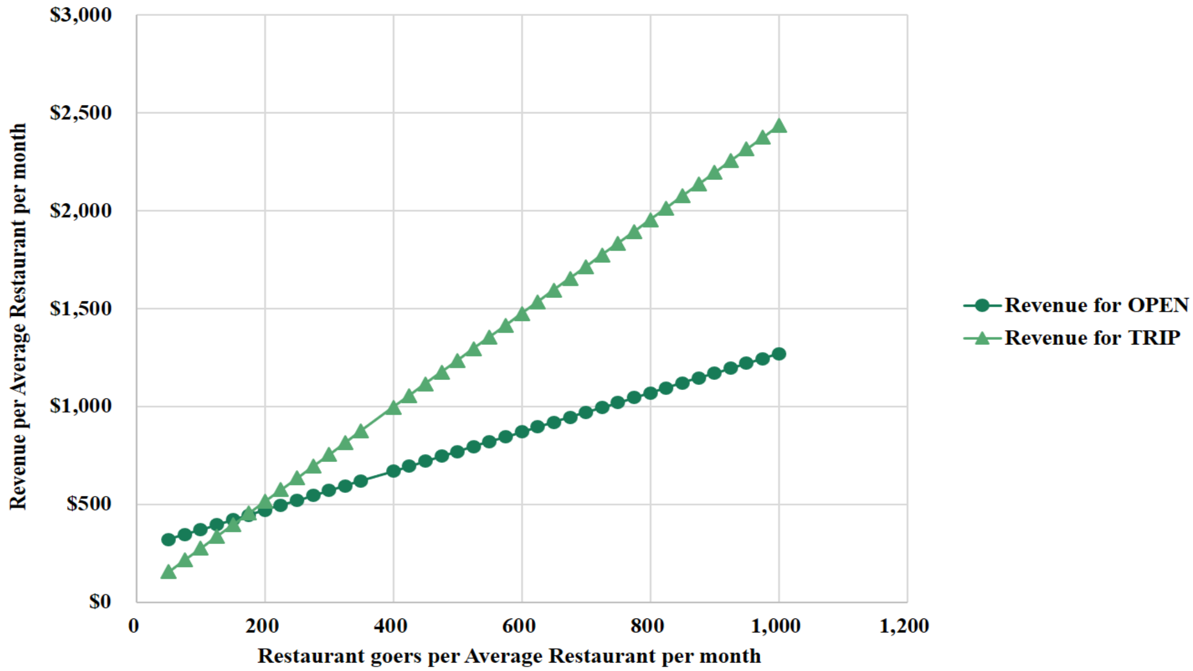
Similar to OpenTable, TripAdvisor Restaurants charges a fee per seated diner. However, unlike OpenTable which charged $1 per person back in 2009, TripAdvisor charges €2 per person (~$2.40 using current FX rate). This is *more than double* what OpenTable used to charge.

(c) TripAdvisor Would Make More Revenue Than OpenTable Once Seated Diners *Hit ~168 and the Gap Will Keep Growing As More Seated Diners Come*

Simple math shows that up to 167 seated diners, OpenTable will make more money (using 2009 numbers) than TripAdvisor Restaurants. However, at 168 seated diners, TripAdvisor Restaurants starts making more money than OpenTable (using 2009 numbers) and the gap keeps growing as the number of seated diners increases.

Again – these numbers are for illustrative purposes only and you can make your own assumptions about the tier pricing mix. However, the logic is indisputable: at a certain volume of seated diners, TripAdvisor Restaurants will derive higher revenue per restaurant than OpenTable did (using 2009 numbers).

Here is a graphical illustration of this.



Source: OpenTable filings, TripAdvisor filings, Caro-Kann Capital research.

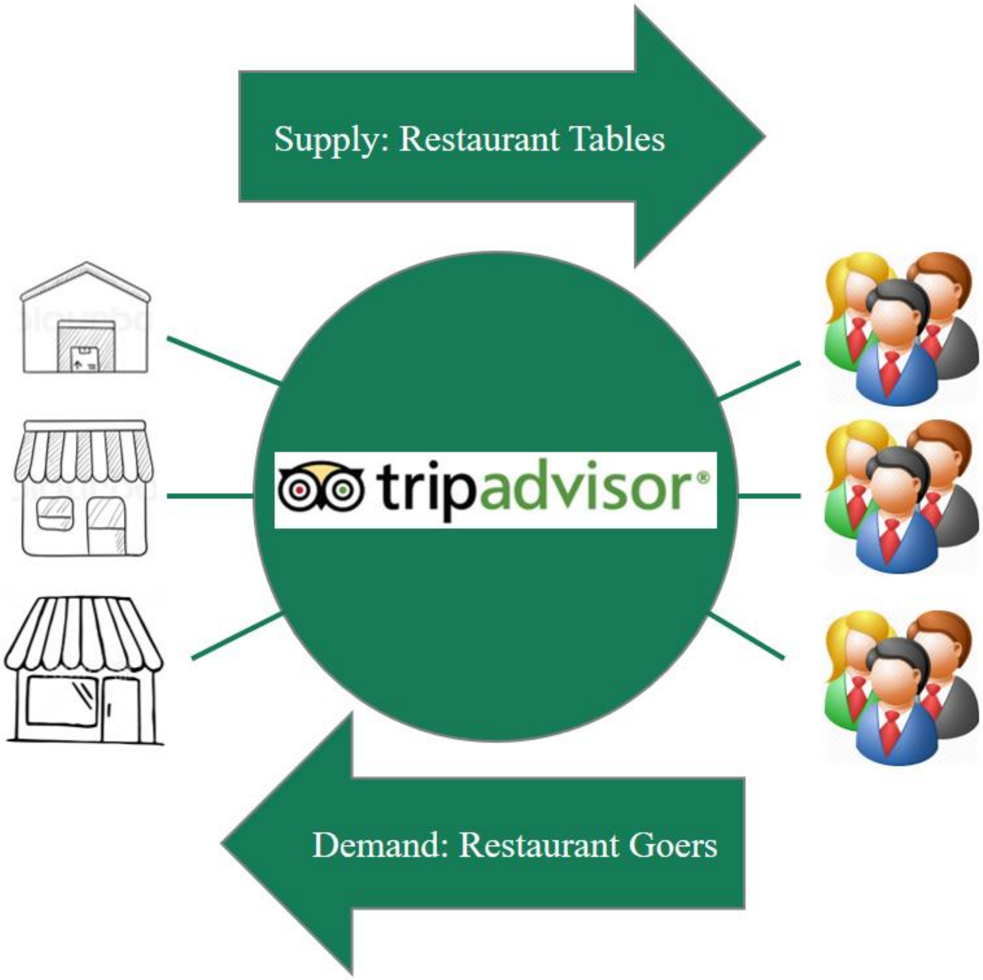
7. Why Is TripAdvisor Restaurant a Fantastic Business?

We believe that TripAdvisor Restaurants is a fantastic business because it is a platform. We also think that it is deeply misunderstood by market participants due to its current financial characteristics. Let's dive more into this.

When TripAdvisor acquired La Fourchette and effectively entered the online restaurant reservations business, it already had lots of traffic to its restaurant pages – *i.e.*, TripAdvisor already had ***demand***. This is very different from the challenge that OpenTable had because it needed to bring *both* supply and demand simultaneously – *i.e.*, it need to solve the notorious chicken-and-egg problem.

By acquiring La Fourchette, TripAdvisor brought ***supply*** – *i.e.*, restaurants with perishable inventory (e.g., dinner tables on a particular night).

Once TripAdvisor put demand and supply together, it created a virtuous cycle.



Source: Caro-Kann Capital research.

It does not take a genius to see that all characteristics that made OpenTable a phenomenal business are present in the case of TripAdvisor Restaurants:

- ✓ Strong network effect.
- ✓ Winner-takes-all dynamics.
- ✓ Wide moat that is expanding over time with every new restaurant joining the platform and every new user creating an account online.
- ✓ Potential entrants face the chicken-and-egg problem.
- ✓ Highly scalable business model.
- ✓ Very high incremental margins.

TripAdvisor management addressed this through the lens of consumer behavior, repeat usage, and falling customer acquisition costs:

> "restaurants … it is a very local product … there tends to be a winner-take-all or close to it in a given city. … if you get enough restaurants and you have enough user demand and enough app installs, that's ***very habit-forming***. You go back to the app. And, in … almost all of these businesses, it's a cost-of-customer acquisition that drives the margin. And, when you can ***get that cost-of-customer acquisition down to be zero because it's a repeat user***, the rest of the business ***just turns out margin***."
>
> *Source: 1Q 2015 TripAdvisor Earnings Call.*

8. TripAdvisor Restaurants: Competition

TripAdvisor Restaurants has a dominant position in most markets where it operates (and possibly in all of them but it is difficult to confirm with 100% certainty). Given that TripAdvisor Restaurants operates in winner-take-all markets, it means ***TripAdvisor Restaurants is the winner***.

The fact that Priceline and OpenTable effectively admitted their defeat in Europe bodes extremely well for TripAdvisor Restaurants and confirms our view that TripAdvisor Restaurants is the winner.

9. TripAdvisor Restaurants: Penetration of Online Reservations

At the time of the La Fourchette acquisition TripAdvisor management compared restaurant online reservations penetration between the U.S. and Europe. According to TripAdvisor management the U.S. had a penetration rate of ~20% while European countries had penetration levels of "single digits" and "in some case low single digits". *Source: 1Q 2014 TripAdvisor Earnings Call*.

TRIP management also predicted a massive growth runway, which we agree with:

> "it's hard for us to see a path whereby huge numbers of travelers, huge number of locals won't be making their … restaurant reservations on their smartphone."
>
> *Source: 2Q 2014 TripAdvisor Earnings Call.*

10. TripAdvisor Restaurants: Key Metrics to Monitor and Forecast

There are two metrics that we need to monitor and forecast for TripAdvisor Restaurants:

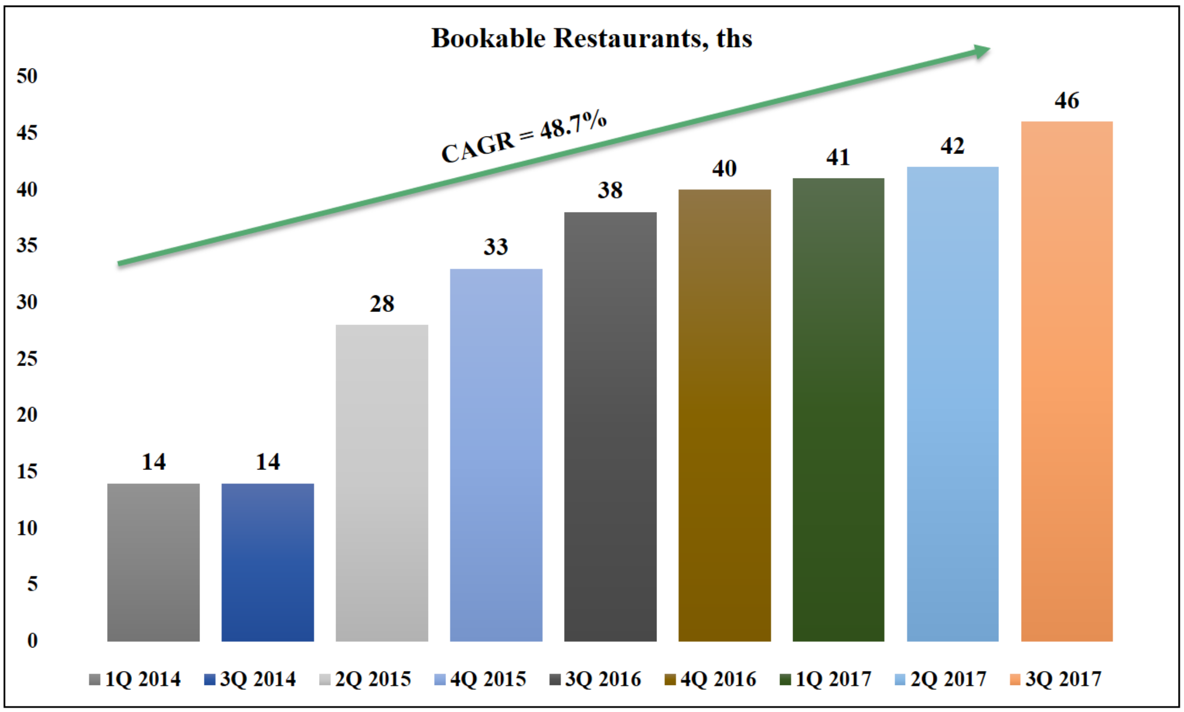
(1) Number of bookable restaurants on the platform and
(2) Number of seated diners.

(a) Bookable Restaurants

TripAdvisor has not consistently disclosed the number of bookable restaurants on the platform after it acquired La Fourchette. Hence, we put together whatever data we could find. While some periods are missing, overall, we have a comprehensive picture.

Bookable restaurants have grown ~3.3x in less than 4 years which translates into ~48.7% CAGR.

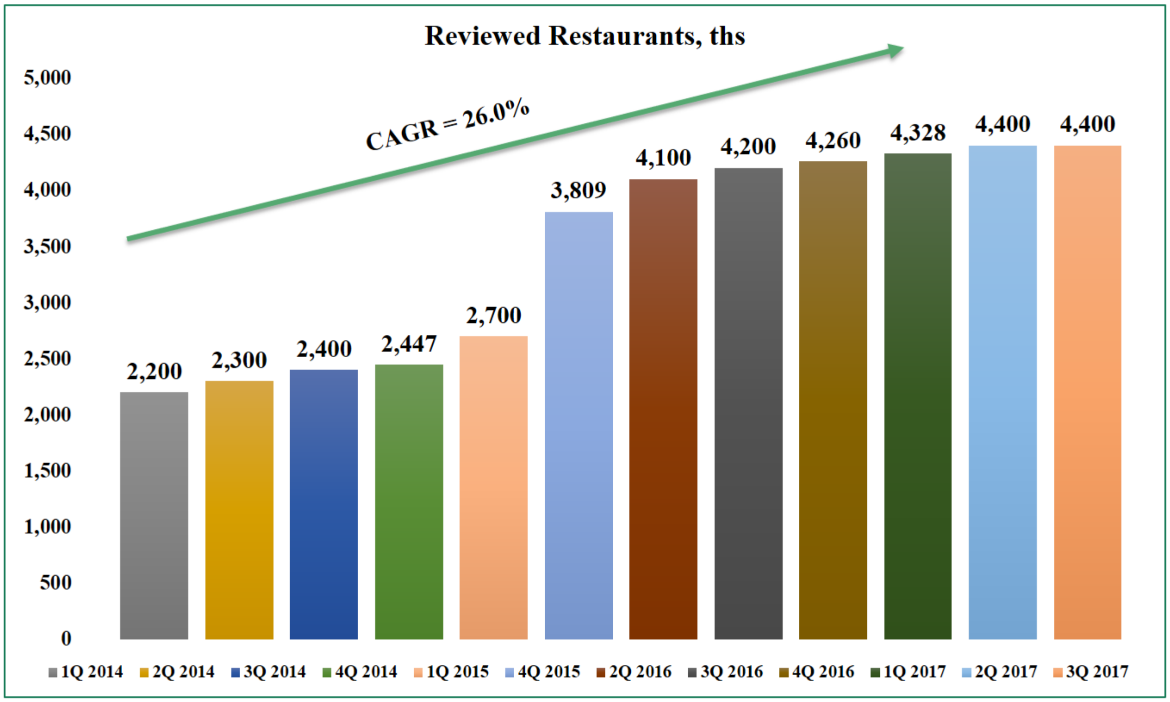
Restaurants: Bookable Restaurants Grew ~3.3x in Less Than 4 Years!



Source: TripAdvisor filings, Caro-Kann Capital research.

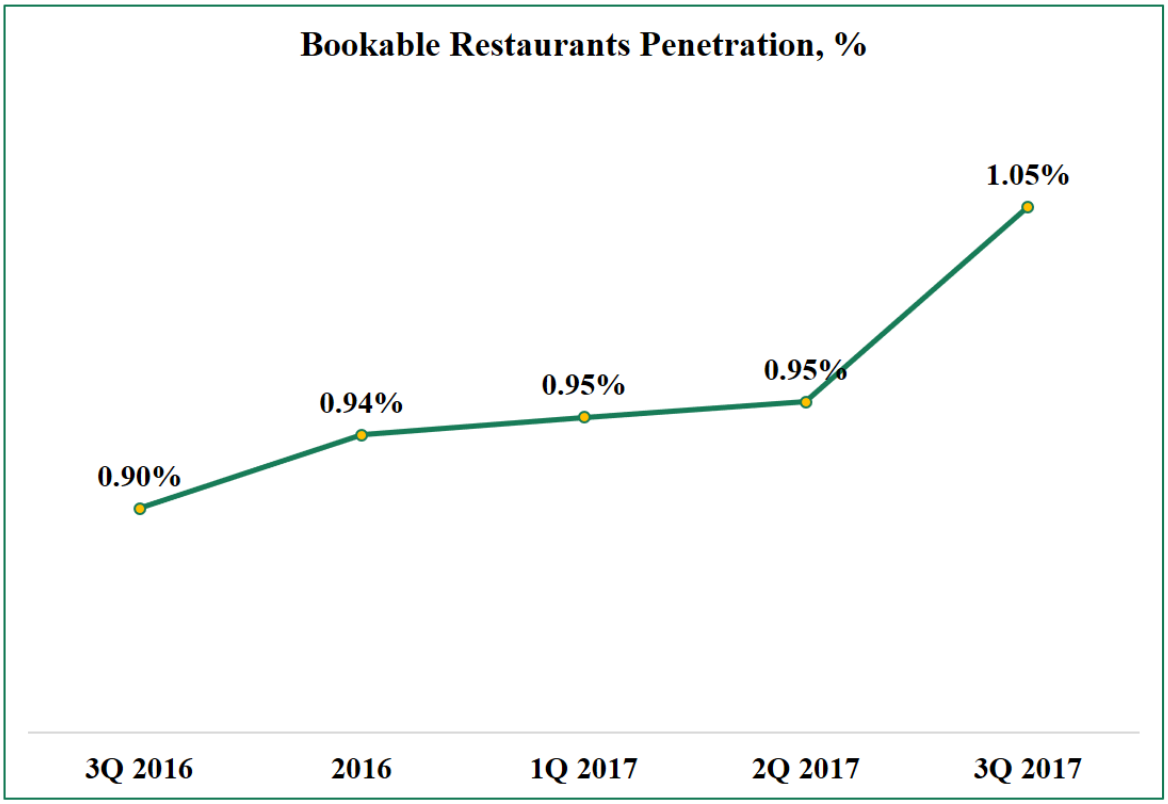
What is interesting, however, is that reviewed restaurants have also been growing rapidly though at a slower CAGR of "only" ~26%. Today there are more than 100x reviewed restaurants than bookable restaurants on TripAdvisor platform.

Restaurants: There Are ~100x More Restaurants That Are Reviewed But Cannot Be Booked Now!



Source: TripAdvisor filings, Caro-Kann Capital research.

Thus, the penetration of bookable restaurants as per cent of reviewed restaurants remains extraordinary low: just slightly above 1%.



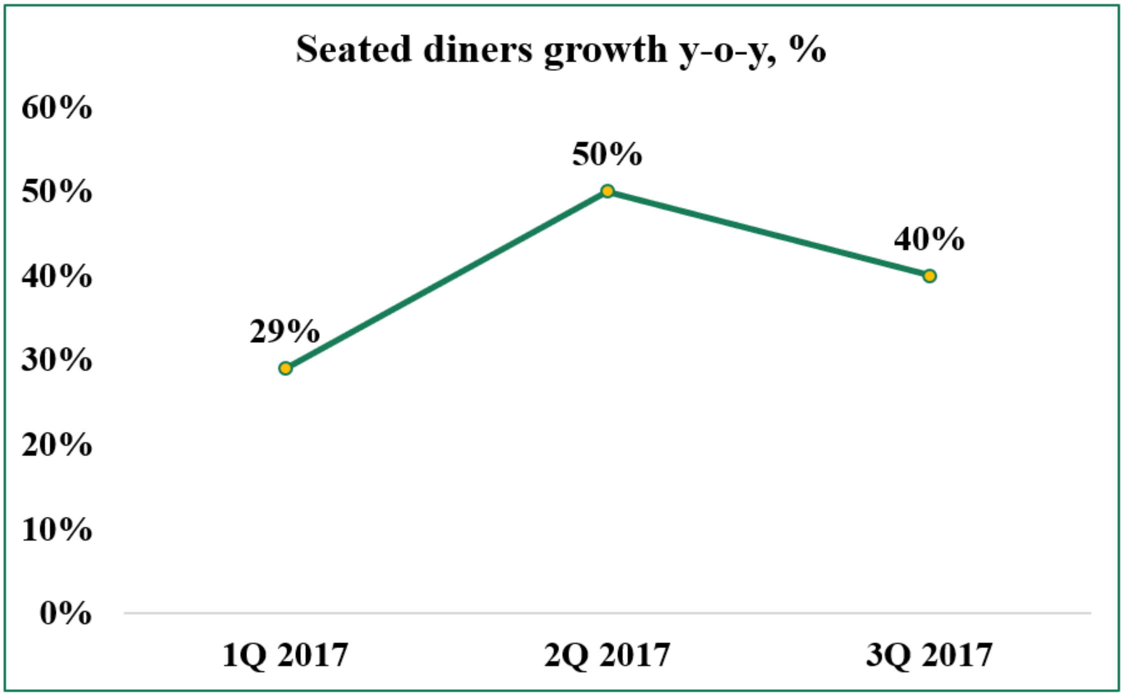
Source: TripAdvisor filings, Caro-Kann Capital research.

So the gap between ~46,000 bookable restaurants and 4,400,000 reviewed restaurants is simply *massive*. Obviously, reviewed restaurants include restaurants in the U.S. where OpenTable dominates the industry. Reviewed restaurants also include "hole in the wall" places and food trucks that would never need online reservations.

But we are not forecasting that penetration will go above even 10% long-term either! Even if penetration increases to 2% or 3%, TripAdvisor and its shareholders will benefit *tremendously*.

(b) Seated Diners

TripAdvisor never disclosed seated diners or seated diners per restaurant. However, in 1Q 2017 TripAdvisor started disclosing year-over-year ***growth in seated diners***. By now we have three quarters of data. Below we provide a graph of what we know.



Source: TripAdvisor filings, Caro-Kann Capital research.

Based on the history of OpenTable, we expect two factors to drive growth in seated diners:

(1) More restaurants join the platform and become bookable.
(2) Number of seated diners per restaurant increases as the network grows and user engagement increases.

Given these factors, we expect that seated diners can grow 20% - 30% per year for many years.

We also think that most market participants do not think much about these drivers. Even if they do, they likely think in *linear* terms. As we showed in our case study of OpenTable, a ***linear function fails to account for the intricacies of network effects***.

11. <u>TripAdvisor Restaurants: How Big Can It Be?</u>

TripAdvisor Restaurants revenue has never been disclosed. Recently TRIP management hinted on a relative size of its three Non-Hotel businesses:

> "In terms of relative sizes, I don't want to be too specific in breaking it out because we haven't broken it out, but Attractions is the largest of the 3 components, with the other 2 smaller."
>
> *Source: 3Q 2017 TRIP Earnings Call.*

While we still do not exactly know how big Restaurants business is, we think that using 20% to 25% of the entire Non-Hotel business is not unreasonable. We know that 3Q 2017 LTM Non-Hotel revenue is ~$347M. Thus, Restaurants business 3Q 2017 LTM revenue is between ~$69.5M and ~$87M.

But how big can it be?

This is what we know:

- ✓ Number of bookable restaurants
- ✓ Subscription fee
- ✓ Per seated diner fee.

This is what we do ***not*** know:

- ✓ Mix of restaurants in terms of tiered pricing
- ✓ Seated diners number.

We can make reasonable estimates for these unknowns either at this point in time or several years out.

We already discussed our assumptions for the **mix of restaurants in terms of tiered pricing**. Hence, we can just stick to them: ~55% restaurants paying €0, ~35% restaurants paying €59, and ~15% restaurants paying €89). This mix results in a weighted average subscription fee of €30 per month or ~$36 per month.

Seated diners are more difficult to estimate either now or in the future. However, we can use OpenTable's history to make reasonable assumptions about seated diners per restaurant. Based on them, we can estimate ***how big TripAdvisor Restaurants business can become***.

Below we provide our estimates of how much revenue TripAdvisor Restaurants can generate using the methodology outlined above.

# of restaurants, ths	Year for OpenTable Key Metrics	Seated diners per restaurant, ths	Fee per diner, EUR	FX	Reservations revenue, mln $	Average subscription fee month, EUR	Subscription revenue, mln $	Total revenue, mln $
46	2008	4.0	2.00	1.20	445.1	29.55	19.6	464.7
46	2009	4.2	2.00	1.20	459.3	29.55	19.6	478.9
46	2010	5.1	2.00	1.20	559.3	29.55	19.6	578.9
46	2011	5.8	2.00	1.20	638.8	29.55	19.6	658.4
46	2012	6.1	2.00	1.20	675.5	29.55	19.6	695.1
46	2013	6.6	2.00	1.20	729.6	29.55	19.6	749.1

Source: OpenTable filings, TripAdvisor filings, Caro-Kann Capital research.

We have also displayed a year for OpenTable's seated diners per restaurant to put this metric in a historical context.

We will point out the obvious. OpenTable had only 9,295 restaurants in North America at the end of 2008. Yet each restaurant had ~4,000 seated diners per year. But it was ***9 years ago!*** Penetration of smartphones was extremely low at that time. It was still the iPhone 2 era! Importantly, shift to mobile usage benefits online reservations space.

There is no reason to believe that TripAdvisor Restaurants will have fewer seated diners per restaurant in 2020 or 2022 than OpenTable had in North America in 2008.

Importantly, even using 2008 OpenTable numbers, the revenue potential of Restaurants is ~$465M or 6x of mid-point current estimated revenue. In other words, ***we do not need to make any heroic assumptions to expect TripAdvisor Restaurants to become a very large business***.

If we use OpenTable 2013 seated diners per average restaurant metric, TripAdvisor Restaurants' revenue potential is even more astonishing – ~$750M or ~9.6x of mid-point current estimated revenue!

We should point out that these calculations assume ***no single new restaurant joining*** the platform! This is obviously an unrealistic assumption as we expect growth in bookable restaurants to continue.

If we assume that the number of bookable restaurants doubles to reach ~92K restaurants on the platform by 2022 and seated diners reach in 2022 the level that OpenTable was enjoying in 2013 (*i.e.*, 9 years before), then TripAdvisor Restaurant business can be ~$1.5B revenue enterprise. To put things in perspective, 3Q 2017 LTM Revenue for entire TripAdvisor (both Hotel and Non-Hotel) is ~$1.5B.

Given the massive opportunity that TripAdvisor Restaurants is facing, we believe that its revenue can grow 20% – 30% a year for many years driven by low penetration of bookable restaurants, increasing adoption of online reservations, and increasing customer engagement.

12. <u>TripAdvisor Restaurants: Profitability and Margins</u>

TripAdvisor has never disclosed any profitability metric for its Restaurants business. However, we were able to put a few pieces of the mosaic together.

This is what TRIP management wrote while discussing 2Q 2017 results:

> "restaurants … achieving topline scale that will help it ***approach Adjusted EBITDA breakeven this year***."
>
> *Source: 2Q 2017 TripAdvisor Prepared Remarks.*

This is what TripAdvisor management wrote one quarter later while discussing 3Q 2017 results:

> "Restaurants … ***turned Adjusted EBITDA positive in the quarter*** amidst continued investment in sales, marketing and product experience."
>
> *Source: 3Q 2017 TRIP 8-K.*

We believe that ***Restaurants margins have been negative for a long time <u>purely</u> due to heavy investments*** in growth initiatives, signing up more restaurants, and expanding into more countries. These initiatives run through income statement as sales and marketing expenses and made it hard to see how good the business is. When TripAdvisor acquired La Fourchette, it hinted that La Fourchette was profitable or at least growing profitably. More importantly, we saw in our historical case study of OpenTable that ~40% EBITDA margins are definitely achievable. We would also point out that TRIP management was referring to Adjusted EBITDA

(EBITDA + SBC) while the OpenTable case study focused on EBITDA (*i.e.*, after SBC), and all else being equal Adjusted EBITDA margins should be higher than EBITDA margins.

Finally, it is possible that TripAdvisor Restaurants margins would be a bit lower that OpenTable's margins in North America given that TripAdvisor Restaurants operates in multiple countries which may mean higher operating costs. However, we do not expect the difference to be more than 5 to 7 percentage points.

How can we forecast TripAdvisor Restaurants margins once the business reaches scale? We will rely on what OpenTable achieved in North America in 2008 through 2013 and pick the margin from a respective year that "matches" revenue potential based on *the same year* seated diners per restaurant. Again, this exercise is designed to develop a range of EBITDA that TripAdvisor Restaurants can achieve in a few years.

Year for OpenTable Key Metrics	Total revenue, mln $	EBITDA margin, %	EBITDA, mln $
2008	464.7	24.7%	110
2009	478.9	29.9%	137
2010	578.9	35.6%	199
2011	658.4	42.9%	274
2012	695.1	38.2%	258
2013	749.1	41.2%	301

Source: OpenTable filings, TripAdvisor filings, Caro-Kann Capital research.

13. <u>TripAdvisor Restaurants: Valuation</u>

We will conduct valuation of TripAdvisor Restaurants assuming that it can achieve EBITDA levels that we outlined above in 5 years and alternatively 10 years. This will create a fairly broad valuation range.

We will assume share dilution of 2% a year for respective time periods.

We will use 14x EBITDA multiple as we think it is appropriate for a business of such extraordinary quality and its strong moat.

This is our valuation of TripAdvisor Restaurants in 5 years.

Restaurants: Valuation in 5 Years

Year for OpenTable Key Metrics	EBITDA, mln $	Multiple	EV, mln $	Share count in 5 years	Restaurants Price per Share, $
2008	110	14.0x	1,540	153.5	$10.0
2009	137	14.0x	1,921	153.5	$12.5
2010	199	14.0x	2,787	153.5	$18.2
2011	274	14.0x	3,834	153.5	$25.0
2012	258	14.0x	3,611	153.5	$23.5
2013	301	14.0x	4,207	153.5	$27.4

This is our valuation of TripAdvisor Restaurants in 5 years.

Restaurants: Valuation in 10 Years

Year for OpenTable Key Metrics	EBITDA, mln $	Multiple	EV, mln $	Share count in 10 years	Restaurants Price per Share, $
2008	110	14.0x	1,540	169.4	$9.1
2009	137	14.0x	1,921	169.4	$11.3
2010	199	14.0x	2,787	169.4	$16.5
2011	274	14.0x	3,834	169.4	$22.6
2012	258	14.0x	3,611	169.4	$21.3
2013	301	14.0x	4,207	169.4	$24.8

Please note that we are not presenting valuation of TripAdvisor Restaurants based on acquisition multiples of OpenTable – either EV / LTM Revenue or EV / LTM EBITDA – because such approach results in extraordinary high valuation of TripAdvisor.

However, as a thought experiment we will share TripAdvisor Restaurants valuation based on EV per restaurant that Priceline paid for OpenTable.

TripAdvisor Restaurants Valuation Based on EV per Restaurant That Priceline *Actually* Paid for OpenTable

Number of Restaurants, ths	46
OpenTable EV/Restaurant at Acquisition, $ ths	81.9
TripAdvisor Restaurants Enterprise Value, $ mln	**3,767.9**
Share count now	139.0
TripAdvisor Restaurants value per share, $	**$27.1**
Share count in 5 years	153.5
TripAdvisor Restaurants value per share, $	**$24.6**
Share count in 10 years	169.4
TripAdvisor Restaurants value per share, $	**$22.2**

Source: OpenTable filings, TripAdvisor filings, Caro-Kann Capital research.

And this is our valuation of TripAdvisor Restaurants based on EV per restaurant that Priceline paid for OpenTable taking into account its subsequent goodwill impairment.

TripAdvisor Restaurants Valuation Based on EV per Restaurant That Priceline *Should Have* Paid for OpenTable – *i.e.*, After Goodwill Impairment

Number of Restaurants, ths	46
OpenTable EV/Restaurant, Adjusted for Goodwill impairment, $ ths	52.1
TripAdvisor Restaurants Enterprise Value, $ mln	**2,397.8**
Share count now	139.0
TripAdvisor Restaurants value per share, $	**$17.3**
Share count in 5 years	153.5
TripAdvisor Restaurants value per share, $	**$15.6**
Share count in 10 years	169.4
TripAdvisor Restaurants value per share, $	**$14.2**

Source: OpenTable filings, TripAdvisor filings, Caro-Kann Capital research.

14. TripAdvisor Restaurants Valuation: Concluding Thoughts

We have demonstrated several valuation approaches that produce a broad range of results between $10 to $30 between *now* and *5 years out*.

We recognize that this is a broad range. However, ***we do not need to make a decision as to what TripAdvisor Restaurants is worth with much precision now***. As more data points become available, we will be able to fine tune our valuation and narrow the range.

The most important thing is that the ***Restaurants Business that has negative LTM EBITDA is worth a substantial amount of money even at the bottom of the range (~$10) compared to the current price of TRIP shares (~$35)***.

The rest is positive open-ended optionality.

VIII. TripAdvisor Attractions: A Great Platform Business that Nobody Is Paying Attention to Either

1. Attractions' History: Evolution from Review Pages with Next to Zero Monetization to a Major Platform Business

The history of TripAdvisor Attractions business and its evolution are remarkably similar to those of TripAdvisor Restaurants.

Prior to 2014 TripAdvisor enjoyed lots of traffic to attractions pages on its website. However, there was no real monetization of that traffic.

In 3Q 2014 TripAdvisor closed an acquisition of Viator for ~$200M, which was a *game changer*. The "real" Attractions business got started!

At the time of the acquisition Viator had more than 20,000 bookable tours and attractions on its platform. Viator also featured more than 600,000 user reviews, photos, and videos.

2. TripAdvisor Management Clearly Outlined Its Vision for Attractions Business from the Beginning

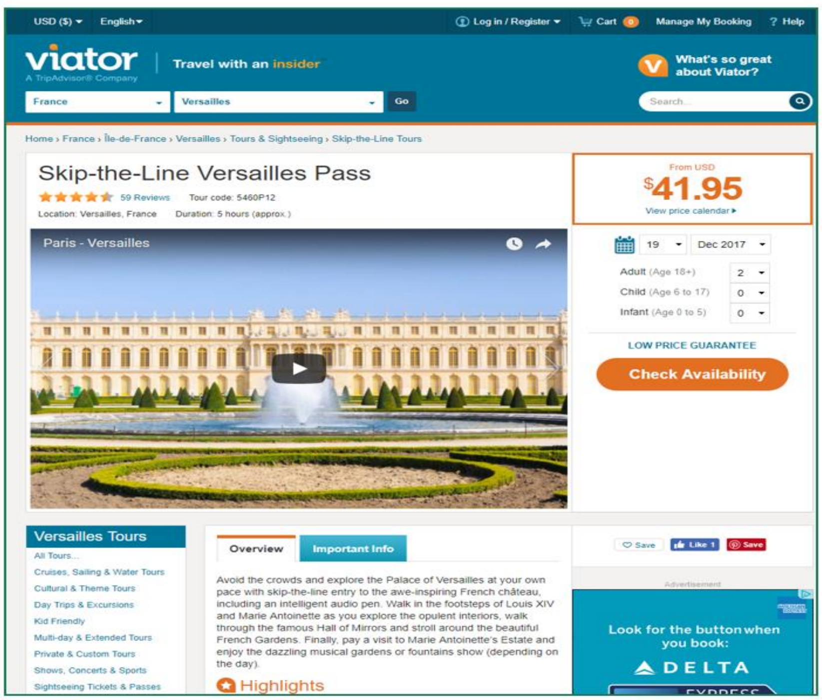
Shortly after TripAdvisor completed the acquisition of Viator, management laid out its vision for TripAdvisor Attractions business:

> "if we can hope for our destiny to be that [of] online travel agency for attractions, then TripAdvisor brings the demand, Viator brings the supply, and it's a pretty nice match on a product that is sold online with high margins. Gosh, looks very similar to the hotel space, and we all know a couple of OTAs in the hotel space that are very big and very profitable. So, we like those proof points."
>
> *Source: 1Q 2015 TripAdvisor Earnings Call.*

3. <u>TripAdvisor Attractions: Incredible Product Experience</u>

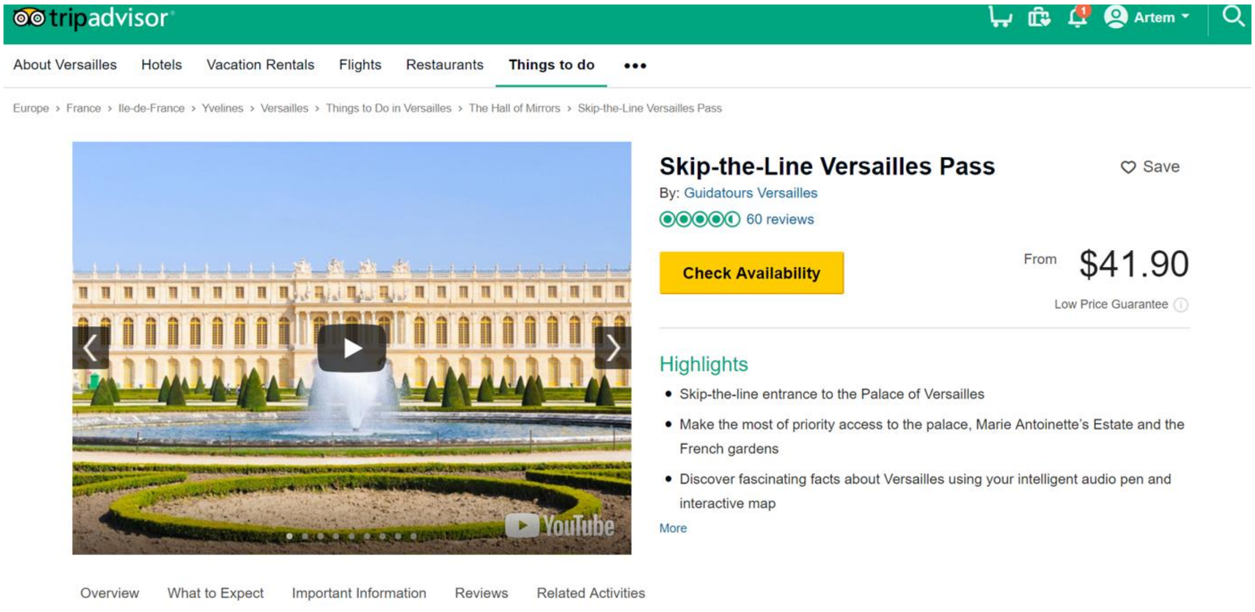
Travelers can purchase attraction such as tours, museum tickets, etc. on www.viator.com, www.tripadvisor.com and through the TripAdvisor app. Buying on TripAdvisor is super convenient because you can read reviews, make a purchase decision and then immediately book an attraction of interest. On top of this, you will save lots of time by skipping lines! In our opinion using TripAdvisor Attractions is a no-brainer!

We have searched for tickets for Versailles that would also allow us to skip lines. This is how booking page for this attraction appears on www.viator.com:



Source: www.viator.com

This is how booking page for the same attraction appears on www.tripadvisor.com:



Source: www.tripadvisor.com

4. TripAdvisor Attractions: TAM

Phocuswright, the leading research provider in the travel space, estimates the total addressable market for Attractions to be ~$80B.

5. How Does TripAdvisor Attractions Make Money?

The Attractions business uses a commission model similar to OTAs in the hotel space. However, TripAdvisor Attractions commissions are even higher than what OTAs charge hotels. OTAs charge hotels 15% to 20%. TripAdvisor Attractions charges vendors 20% to 25%.

We would point out TripAdvisor Attractions faces ***extremely fragmented base of vendors*** that possess ***little bargaining power*** and have very little resources to compete with TripAdvisor Attractions by acquiring customers directly. This is very different from OTAs who face a few giant hotel players (in addition to smaller chains and independent hotels), and those large chains always try to get customers directly to their websites.

Thus, in our view, ***TripAdvisor Attractions is a better business than OTAs due to (1) higher commissions and (2) lower bargaining power of vendors***.

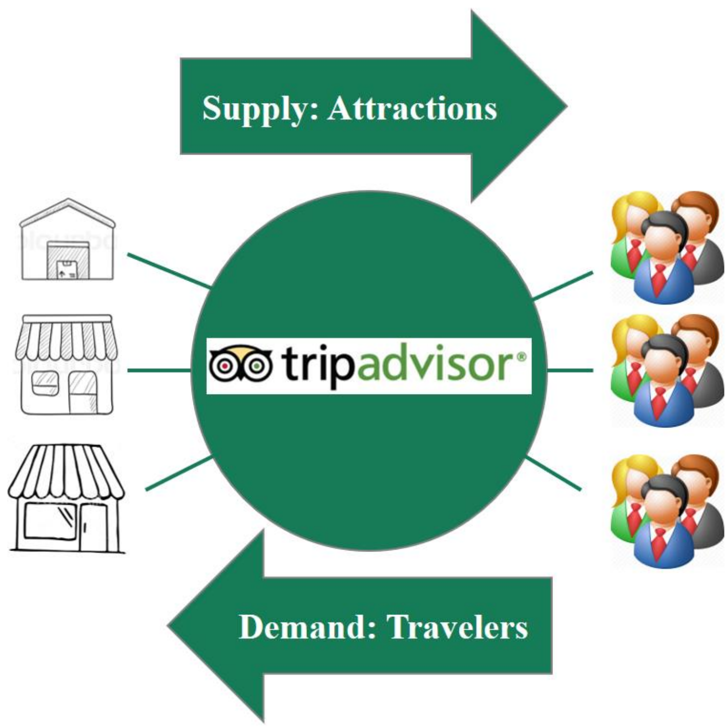
6. Why Is TripAdvisor Attractions a Fantastic Business?

When TripAdvisor acquired Viator and effectively entered the online reservations attractions business, it already had lots of traffic to its attractions pages – *i.e.*, TripAdvisor already had ***demand***.

By acquiring Viator TripAdvisor brought ***supply*** – *i.e.*, attractions vendors with perishable inventory (e.g., tours, tickets, etc.). This situation is extremely similar to what TripAdvisor did in the online restaurant reservations space.

Once TripAdvisor put demand and supply together, it created a virtuous cycle.

TripAdvisor Attractions: Supply And Demand



Source: Caro-Kann Capital research.

It does not take a genius to see that characteristics that made OpenTable and TripAdvisor Restaurants phenomenal businesses are present in the case of TripAdvisor Attractions:

- ✓ Strong network effect.
- ✓ Winner-takes-all dynamics.
- ✓ Wide moat that is expanding over time with every new restaurant joining the platform and every new user creating an account online.
- ✓ Potential entrants will face a chicken-and-egg problem.
- ✓ Highly scalable business model.
- ✓ Very high incremental margins.

7. <u>TripAdvisor Attractions: Competition</u>

TripAdvisor Attractions is the biggest player in the attraction reservations online space. Some other players such as Expedia have attractions offerings as well but they are quite behind.

Why do we think this competitive dynamic would continue? We see at least three reasons.

First, TripAdvisor gets massive demand traffic driven by reviews while other players in the space do not get such traffic.

Second, Expedia's attractions business has been and will likely remain a neglected stepchild. It is just too small to *really* matter for Expedia. As a result, we think that when Expedia's attraction business unit has a chance to compete with Viator and then TripAdvisor Attractions, it never got enough resources and managerial attention. We do not think it is likely to change now when the gap between TripAdvisor Attractions and Expedia is probably 2x.

Third, this is a winner-take-all market. TripAdvisor Attractions is the winner and it will be very difficult for anybody to invade its turf.

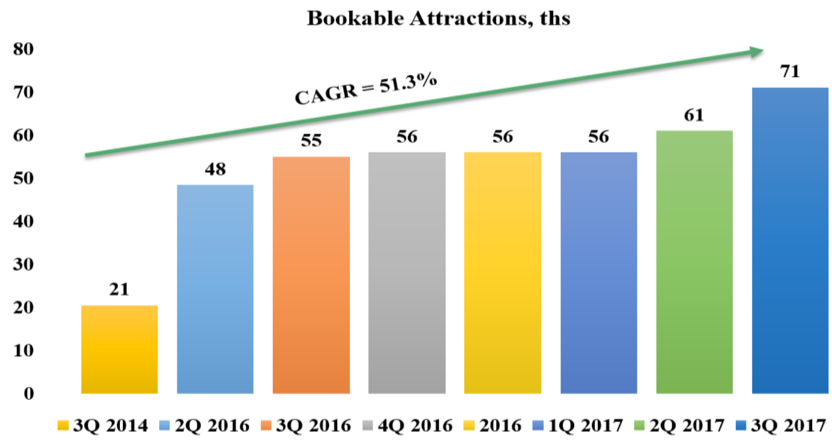
8. <u>TripAdvisor Attractions: Key Metrics to Monitor and Forecast</u>

The key metrics to monitor and forecast are bookable attractions and number of attractions booked.

TripAdvisor has not consistently disclosed the number of bookable attractions on the platform after it acquired Viator. Hence, we have put together whatever data we were able to find. While some periods are missing, overall, we have got a comprehensive picture.

Bookable attractions grew ~3.4x in 3 years which translates into a ~51% CAGR.

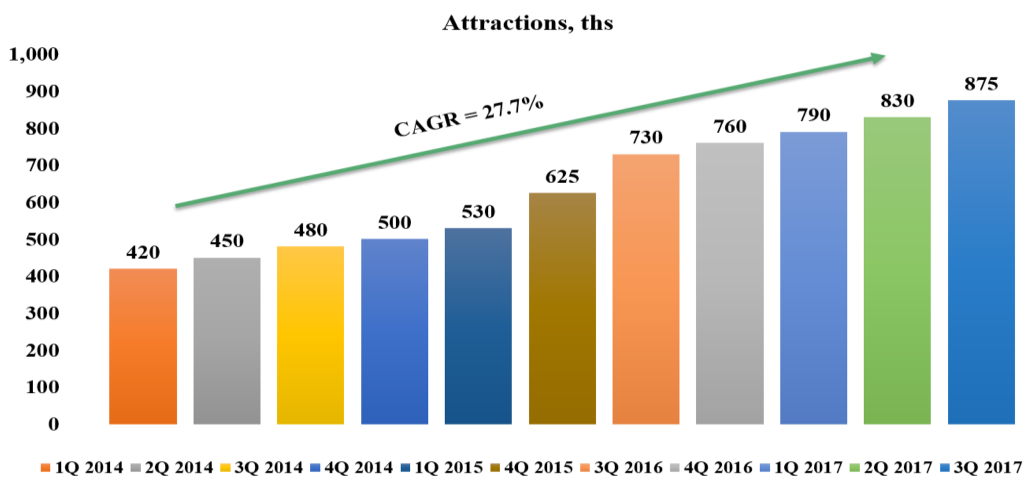
Attractions: Bookable Attractions Grew ~3.4X in Three Years!



Source: TripAdvisor filings, Caro-Kann Capital research.

What is interesting, however, is that reviewed attractions have also grown rapidly though at a slower CAGR of "only" ~27.7%.

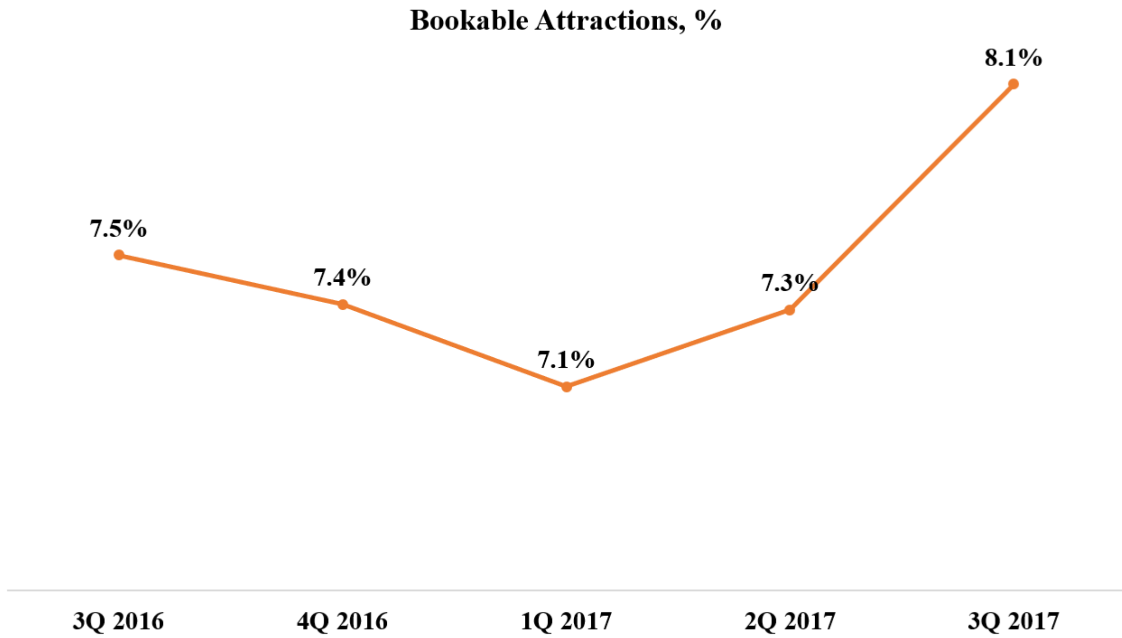
Attractions: Attractions Reviewed Have Been Growing at ~28% CAGR



Source: TripAdvisor filings, Caro-Kann Capital research.

This means that bookable attractions penetration as a per cent of reviewed attractions remains very low:

Attractions: Bookable Attractions Penetration Remains Low!



Source: TripAdvisor filings, Caro-Kann Capital research.

TripAdvisor has never disclosed the number of reserved attractions in any reporting period.

9. <u>TripAdvisor Attractions Faces Long Growth Runway</u>

TripAdvisor Attractions revenue can grow 20% - 30% a year for many years driven by increasing penetration of bookable attractions and increasing adoption of online reservations for attractions.

TripAdvisor management shares the belief that Attractions faces a long growth runway ahead of it. Here are some quotes from management:

> “we expect attractions will be a key driver of Non-Hotel revenue growth and adjusted EBITDA profitability this year”
>
> *Source: 2Q 2017 TripAdvisor Earnings Call.*
>
> “Attractions … we believe has the biggest short-, medium- and long-term upside for us.”
>
> *Source: 2Q 2017 TripAdvisor Earnings Call.*
>
> “But if you take conversion as your near term, you take marketing channel growth as your kind of midterm driver, and continued growth in supply as your long-term driver, you've got a set of beautiful characteristics.”
>
> *Source: 2Q 2017 TripAdvisor Earnings Call.*
>
> “Attractions continues to be a key driver of Non-Hotel segment revenue and profit growth, as we continue to drive both partner supply and traveler demand growth in our marketplace”
>
> *Source: 3Q 2017 TripAdvisor 8-K Prepared Remarks.*

As we mentioned during our TripAdvisor Restaurants discussion, TripAdvisor management recently indicated that Attractions is the largest component of Non-Hotel revenue. If we use 50% as a possible percent of revenue and apply it to 3Q 2017 LTM Non-Hotel revenue of ~$347M, then 3Q 2017 LTM Attractions revenue is ~$173.5M.

To cross-check that, our view of 20% - 30% growth a year for many years based on the penetration rate and increasing user adoption, we can apply a top-down approach.

As we mentioned, Phocuswright estimates the global attractions TAM to be ~$80B. Even if TripAdvisor Attractions can capture 5% of $80B and it charges 20% commission rate, then TripAdvisor can generate revenue of ~$800M ($80B * 5% * 20%) or 4.6x bigger than our estimate of 3Q 2017 LTM Attractions revenue.

The top down approach also indicates that there is a long growth runway.

10. <u>TripAdvisor Attractions Margins and Profitability</u>

TripAdvisor never disclosed much about Attractions' profitability and margins. On 2Q 2017 TripAdvisor Earnings Call management said that "the margins of the business are great", which is not particularly informative.

We will return to the subject of margins later in this investment memorandum.

11. TripAdvisor Attractions: Valuation

We do not have as good of a historical comp for TripAdvisor Attractions as we had for TripAdvisor Restaurants to do detailed valuation work based on user engagement metrics. Instead we will share a valuation "sketch".

As we discussed, we think that Attractions 3Q 2017 LTM revenue was ~$173.5M. We also wrote that we can see a path to $800M over the next few years. The margins could be 40% or even 50%. Let's put together different combinations of these variables. We would assume 2% share dilution a year. We would also assume 14x EBITDA multiple given the quality of the business.

TripAdvisor Attractions: Valuation

		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5	Scenario 6	Scenario 7
Revenue, mln $		**200**	**300**	**400**	**500**	**600**	**700**	**800**
EBITDA margin, %:		**EBITDA, mln $:**						
Bear:	*20%*	40	60	80	100	120	140	160
Base:	*30%*	60	90	120	150	180	210	240
Bull:	*40%*	80	120	160	200	240	280	320
EV/EBITDA		14.0x	14.0x	14.0x	14.0x	14.0x	14.0x	14.0x
Enterprise value, mln $								
Bear:		560	840	1,120	1,400	1,680	1,960	2,240
Base:		840	1,260	1,680	2,100	2,520	2,940	3,360
Bull:		1,120	1,680	2,240	2,800	3,360	3,920	4,480
Share count in 5 years		153.5	153.5	153.5	153.5	153.5	153.5	153.5
Value per Share in 5 Years, $								
Bear:		$3.65	$5.47	$7.30	$9.12	$10.95	$12.77	$14.60
Base:		$5.47	$8.21	$10.95	$13.68	$16.42	$19.16	$21.89
Bull:		$7.30	$10.95	$14.60	$18.24	$21.89	$25.54	$29.19

Source: TripAdvisor filings, Caro-Kann Capital research.

We arrive to a wide range of values. We believe that $15 to $25 of value per share is achievable in a few years.

IX. Vacation Rentals

1. Vacation Rentals: Overview

Vacation Rentals is the least differentiated product within Non-Hotel Business. It is a "me too" product, and several other players offer something similar. For example, HomeAway which was acquired by Expedia also offers vacation rentals.

TripAdvisor offers vacations rentals to have the full breadth of accommodation options to travelers on its website.

Given these characteristics of Vacation Rentals, we will spend the least amount of time analyzing this sub-segment of the Non-Hotel businesses.

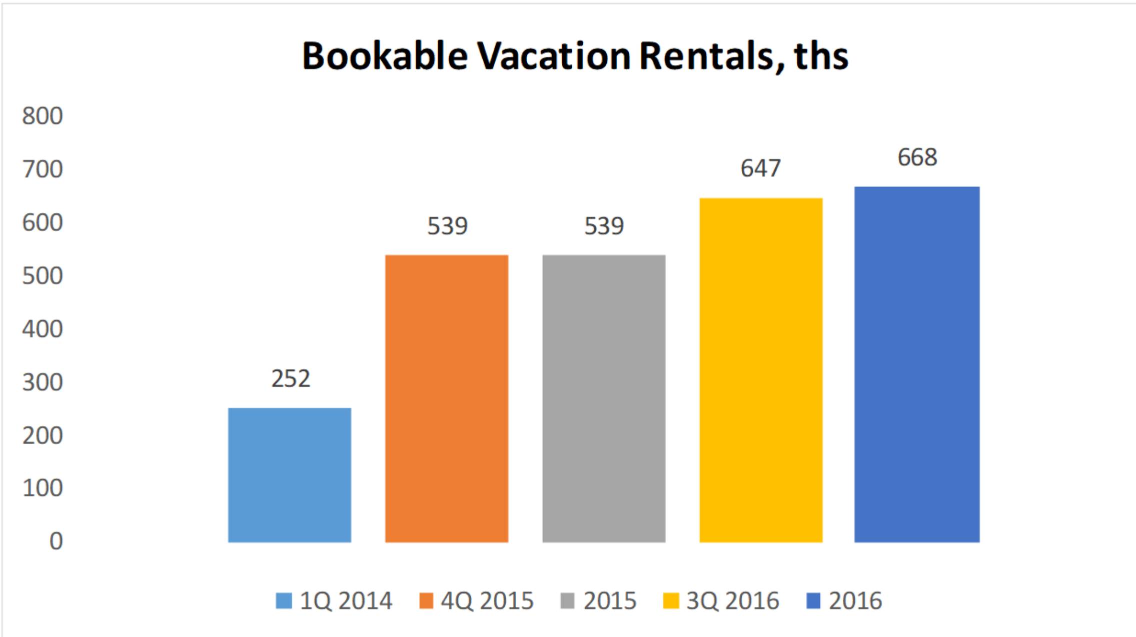
2. Bookable Vacation Rentals: Key Metrics to Monitor and Forecast

The key metric for Vacation Rentals is the number of bookable vacation rentals on the platform because TripAdvisor has never disclosed the number of transactions completed through its platform.

TripAdvisor has not consistently disclosed the number of bookable vacation rental properties on its platform. Hence, we put together whatever data we were able to find. While some periods are missing, overall, we have a comprehensive picture.

Bookable attractions grew ~2.65x in 3 years.

Bookable Vacation Rentals: 2.65x Growth in 3 Years



Source: TripAdvisor filings, Caro-Kann Capital research.

3. <u>TripAdvisor Vacation Rentals: Growth Outlook and Margins</u>

We suspect that Vacation Rentals is the slowest growing subsegment within Non-Hotel Business.

We also suspect that the Vacation Rentals business has been profitable for a long time. Our judgment is based on the performance of its peers and competitors. For example, HomeAway which should be a good comp generated mid-teen EBITDA margins while growing rapidly (before it was acquired by Expedia).

Recently TripAdvisor management said the following about Vacation Rentals:

> "This [Vacation Rentals] remains a complementary, profitable business for us and it nicely rounds out consumers' accommodation options on TripAdvisor".
>
> *Source: 3Q 2017 TRIP Earnings Call.*

Thus, we think that Vacation Rentals will continue to grow 10% - 15% a year for the foreseeable future. We also expect that Vacation Rentals will remain profitable and be a cash generator for TripAdvisor.

4. TripAdvisor Vacation Rentals Valuation

We will not conduct separate valuation of Vacation Rentals and instead will include it into an aggregate valuation of TripAdvisor's Non-Hotel Business.

X. Non-Hotel Business: Historical Financials and Financial Analysis

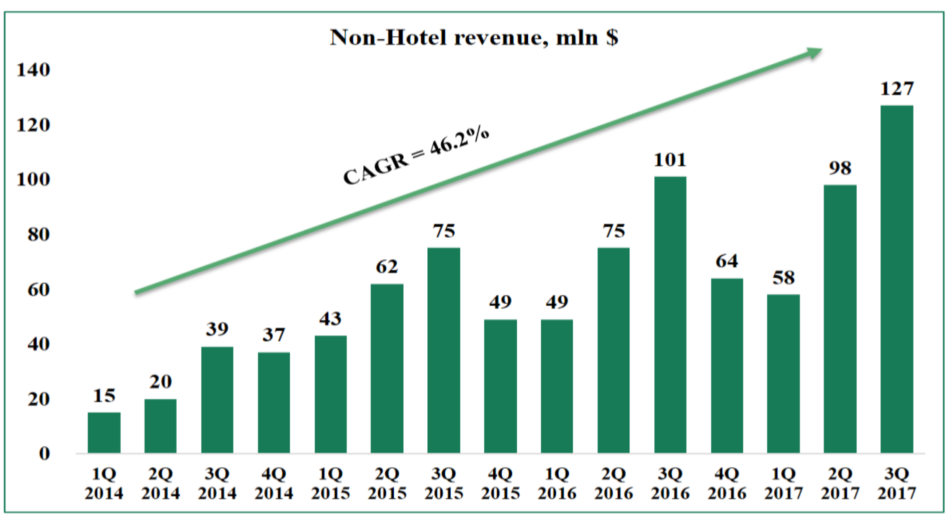
As we discussed above, TripAdvisor discloses revenue and Adjusted EBITDA for its Non-Hotel Business in aggregate and does not break it down by subsegment. Now it is time to review TripAdvisor Non-Hotel Business financials.

1. Non-Hotel Revenue Grew at ~46% CAGR over the Past Four Years

TripAdvisor started reporting Non-Hotel segment in 1Q 2015 and provided data as early as 1Q 2014. Thus, by now we have almost four years of data.

Non-Hotel revenue grew at ~46% CAGR over the past four years.

Non-Hotel Business: Revenue Grew at 46% CAGR



Source: TripAdvisor filings, Caro-Kann Capital research.

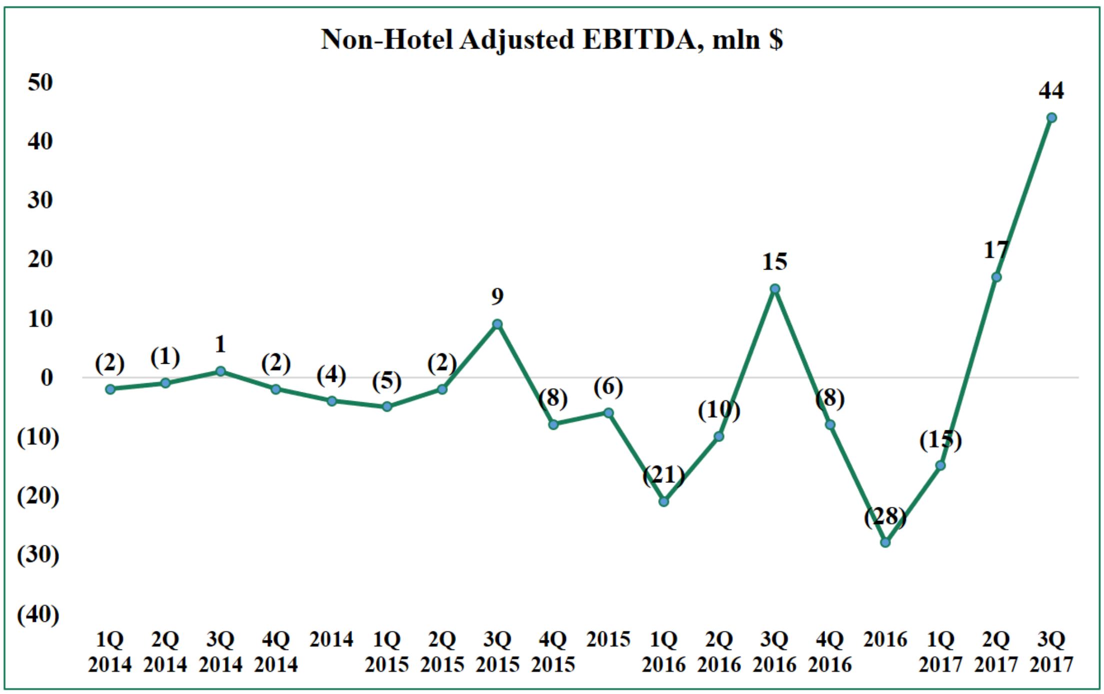
2. Non-Hotel Adjusted EBITDA Has Turned Positive in 2017 and Margins Have Improved Dramatically

TripAdvisor discloses only one profitability metric for the Non-Hotel segment: Adjusted EBITDA (EBITDA + SBC). Thus, we will need to work with this profitability metric.

Adjusted EBITDA was negative during 1Q 2014 – 1Q 2017 with only two exceptions: 3Q 2015 and 3Q 2016. 3Q is the strongest quarter seasonally because of the timing of when most people take their vacations. On the other hand, Non-Hotel Business costs are spread quite equally over all four quarters. This combination results in 3Q being the strongest.

Then Adjusted EBITDA improved dramatically in 2Q and 3Q 2017.

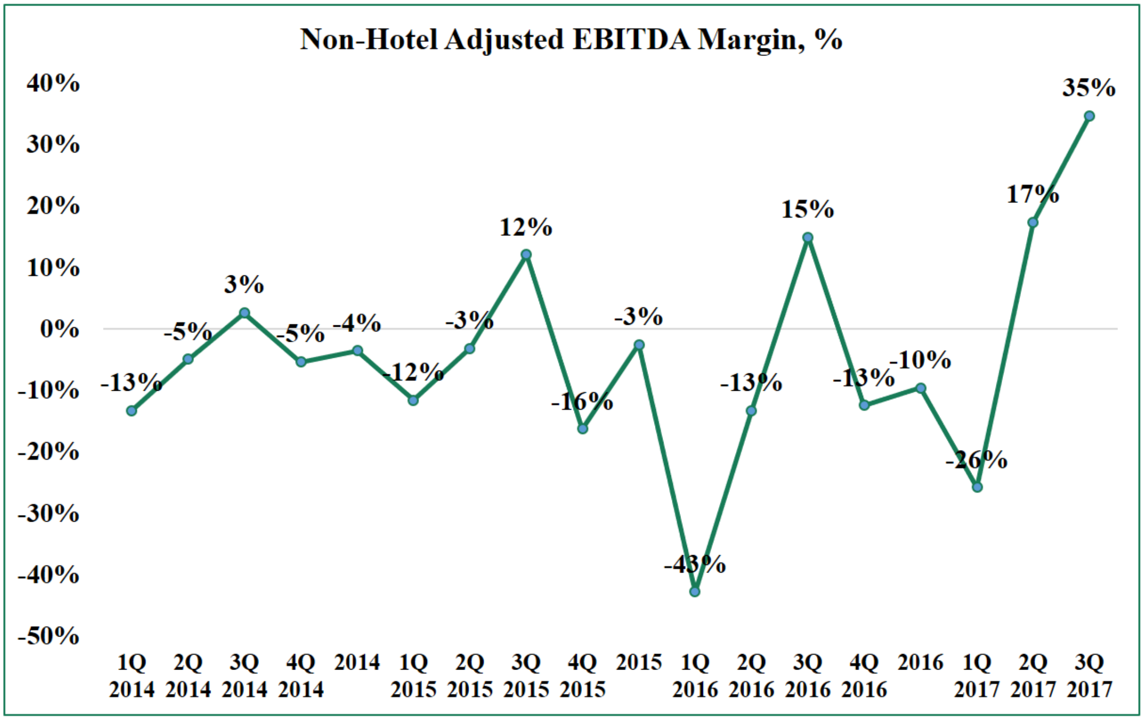
Non-Hotel Business: Adjusted EBITDA Improved Dramatically in 2017



Source: TripAdvisor filings, Caro-Kann Capital research.

The improvement looks even more impressive if we look at Adjusted EBITDA margins.

Non-Hotel Business: Adjusted EBITDA Margin Has Experienced Dramatic Improvement in 2Q and 3Q 2017



Source: TripAdvisor filings, Caro-Kann Capital research.

3. <u>What Are the Implications of Such Dramatic Adjusted EBITDA Margin Improvement in 3Q 2017?</u>

~17% Adjusted EBITDA margin in 2Q 2017 and ~35% Adjusted EBITDA margin in 3Q 2017 are obviously very impressive and encouraging. But what's behind them?

TripAdvisor management did not provide much commentary, but we can do our best to decode this phenomenon. We will focus on 3Q 2017.

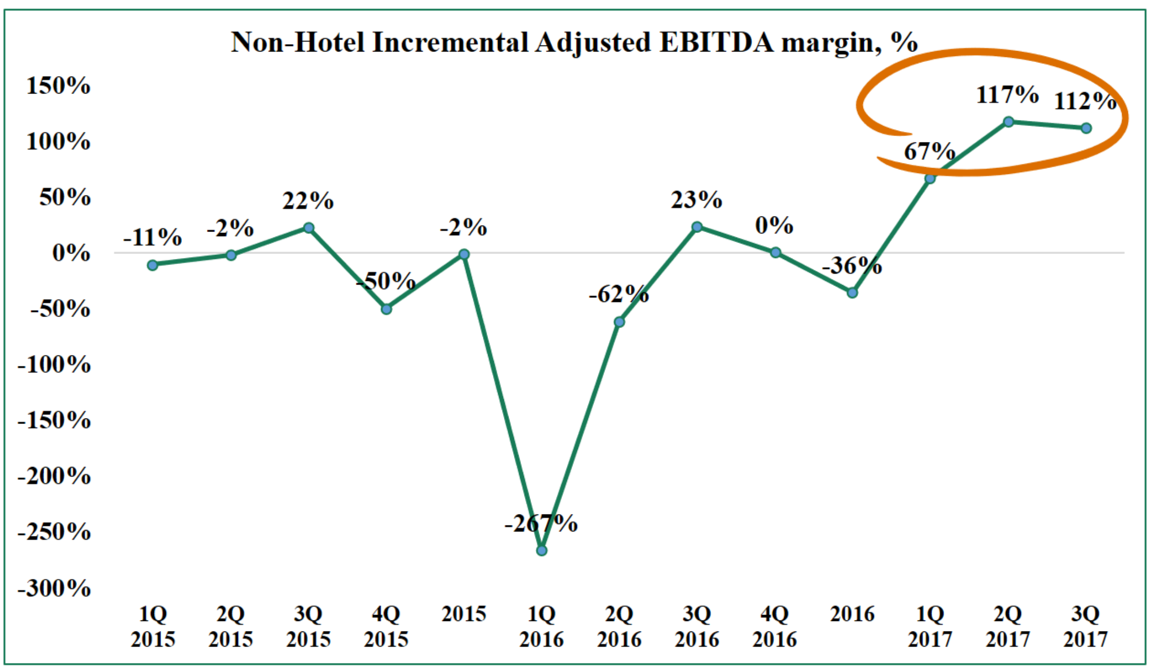
As we wrote before, 3Q is the strongest quarter seasonally. However, Adjusted EBITDA margin improved 20 percentage points and went from 15% in 3Q 2016 to 35% 3Q 2017. So seasonality alone cannot explain everything.

TripAdvisor management mentioned that Restaurants just got above breakeven Adjusted EBITDA in 3Q 2017. Let's call it 2% Adjusted EBITDA margin for Restaurants. We will also stick to the same assumption that we have made before: that Restaurants revenue is between 20% and 25% revenue. These assumptions mean that Attractions and Vacation Rentals together had Adjusted EBITDA margins of 42% to 45% in 3Q 2017. These are OTA-like margins and TripAdvisor is already generating them in two (combined) out of three Non-Hotel businesses! As we previously discussed, we see nothing that would prevent Restaurants getting to 30% to 40% EBITDA margins in a few years.

4. <u>Non-Hotel Incremental Adjusted EBITDA Margins Hit Inflection Point in 1Q 2017</u>

As we discussed in our case study of OpenTable, incremental margins turning positive and performing extremely well is the best leading indicator of a strong margin improvement coming. This is exactly what happened with Non-Hotel Incremental Adjusted EBITDA margins.

TripAdvisor Non-Hotel *Incremental* Adjusted EBITDA Margins Hit Inflection Point in 1Q 2017

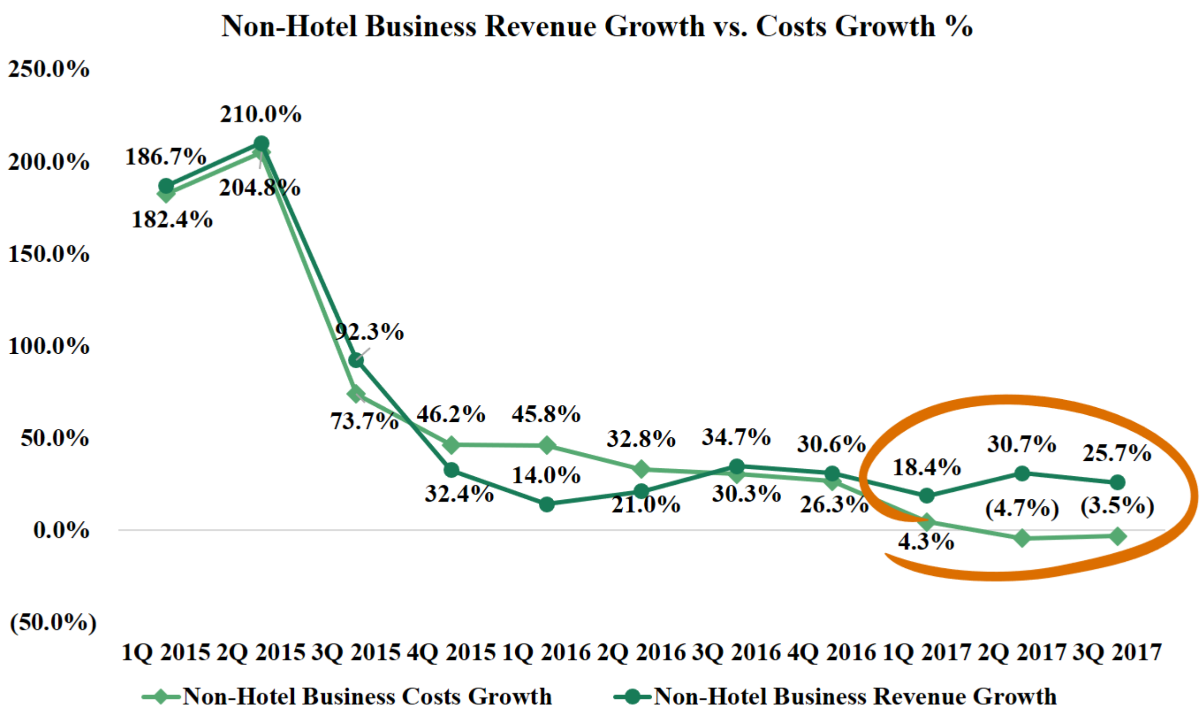


Source: TripAdvisor filings, Caro-Kann Capital research.

5. <u>Non-Hotel Business: Costs Have Been Flat for the Past Three Quarters While Revenue Kept Growing Rapidly</u>

Non-Hotel incremental margins improved radically in the first three quarters of 2017 because costs remained flat while revenue continued to grow.

TripAdvisor Non-Hotel Business: Costs Have Been Flat for the Past Three Quarters While Revenue Kept Growing



Source: TripAdvisor filings, Caro-Kann Capital research.

Thus, Non-Hotel Business started showing signs of very strong operating leverage.

XI. Non-Hotel Business: Financial Forecasts

1. <u>Non-Hotel Business: Revenue Forecast</u>

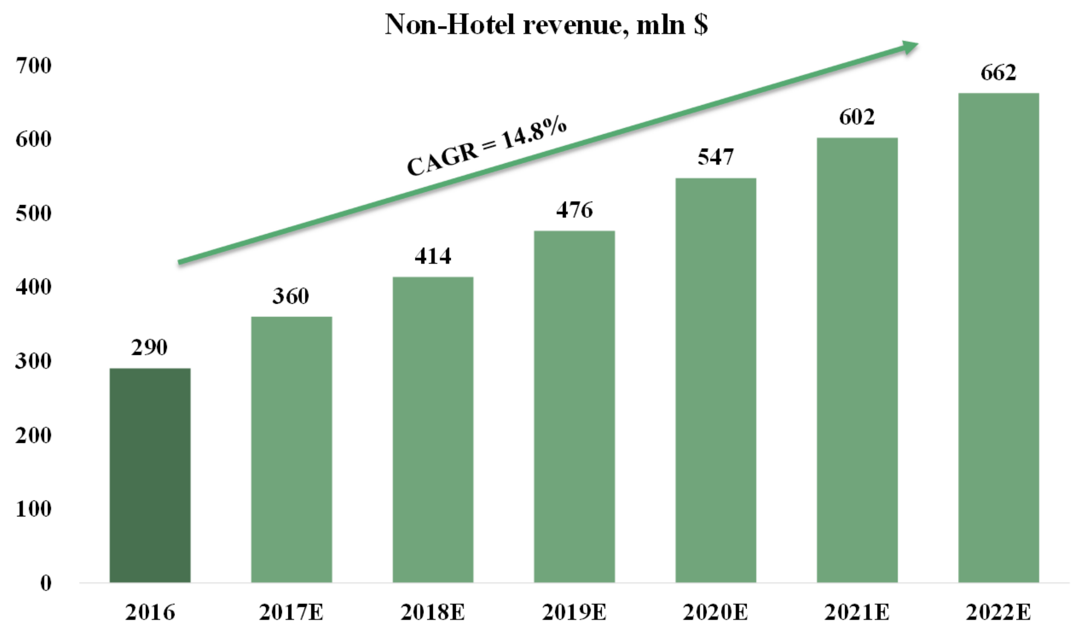
We have already outlined our views on the growth of three subsegments of the Non-Hotel Business. We think Restaurants and Attractions can grow ~20% to 30% a year for many years while Vacation Rentals will grow 10% to 15% a year.

We have built three cases for revenue projections: bear, base, and bull.

(a) Non-Hotel Revenue Forecast: Bear Case

In our bear case, Non-Hotel revenue grows at ~15% CAGR during the 2017 – 2022.

TripAdvisor Non-Hotel Business: Revenue Forecast - Bear Case

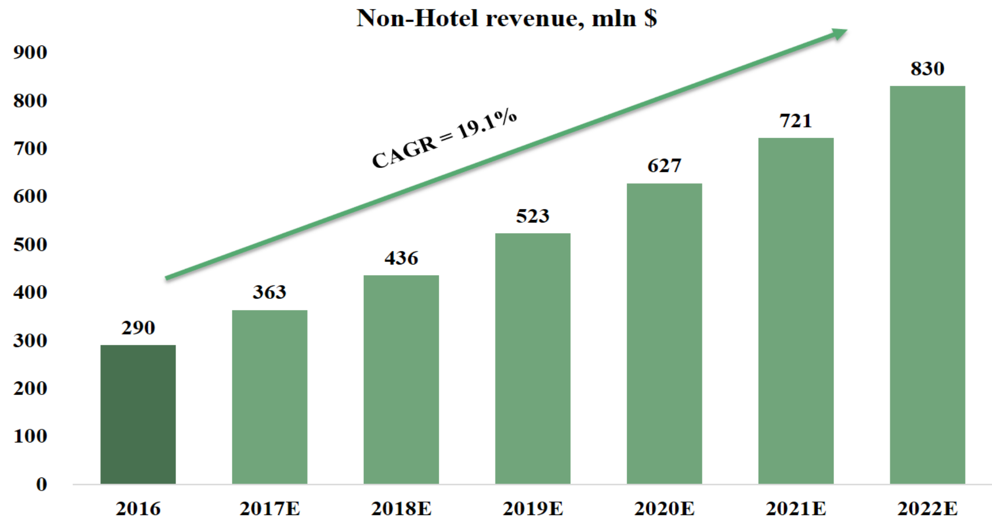


Source: TripAdvisor filings, Caro-Kann Capital research.

(b) Non-Hotel Revenue Forecast: Base Case

In our base case, Non-Hotel revenue will grow at a ~19% CAGR during the 2017 – 2022.

TripAdvisor Non-Hotel Business: Revenue Forecast – Base Case

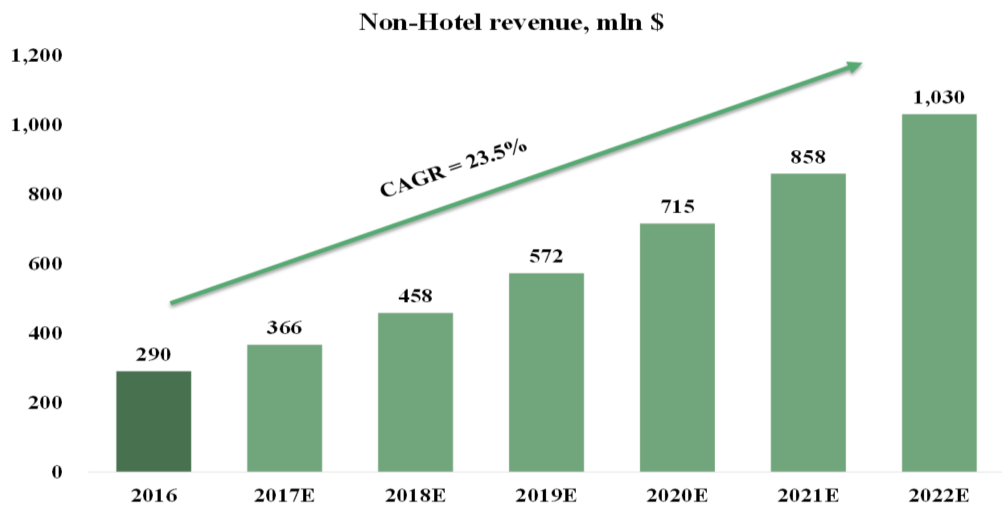


Source: TripAdvisor filings, Caro-Kann Capital research.

(c) *Non-Hotel Revenue Forecast: Bull Case*

In our bull case Non-Hotel revenue will grow ~23.5% CAGR during 2017 – 2022.

TripAdvisor Non-Hotel Business: Revenue Forecast – Bull Case



Source: TripAdvisor filings, Caro-Kann Capital research.

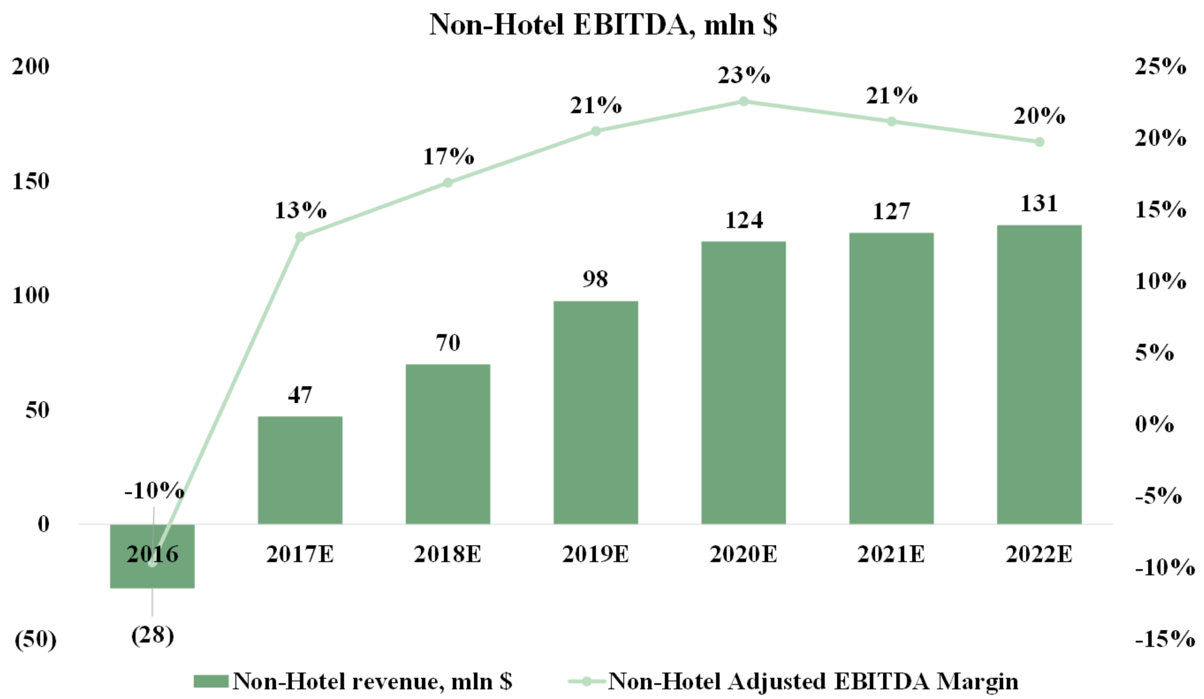
2. <u>Non-Hotel Business: Adjusted EBITDA Forecast</u>

We are forecasting Adjusted EBITDA margins by forecasting the costs of the Non-Hotel business growing at a slower pace than revenue, which we have observed in the first three quarters of 2017. This is how we arrive at our Adjusted EBITDA margins.

(a) Non-Hotel Adjusted EBITDA Forecast: Bear Case

In our bear base Adjusted EBITDA margins reach the low 20% range and remain there.

TripAdvisor Non-Hotel Business: Adjusted EBITDA Forecast – Bear Case

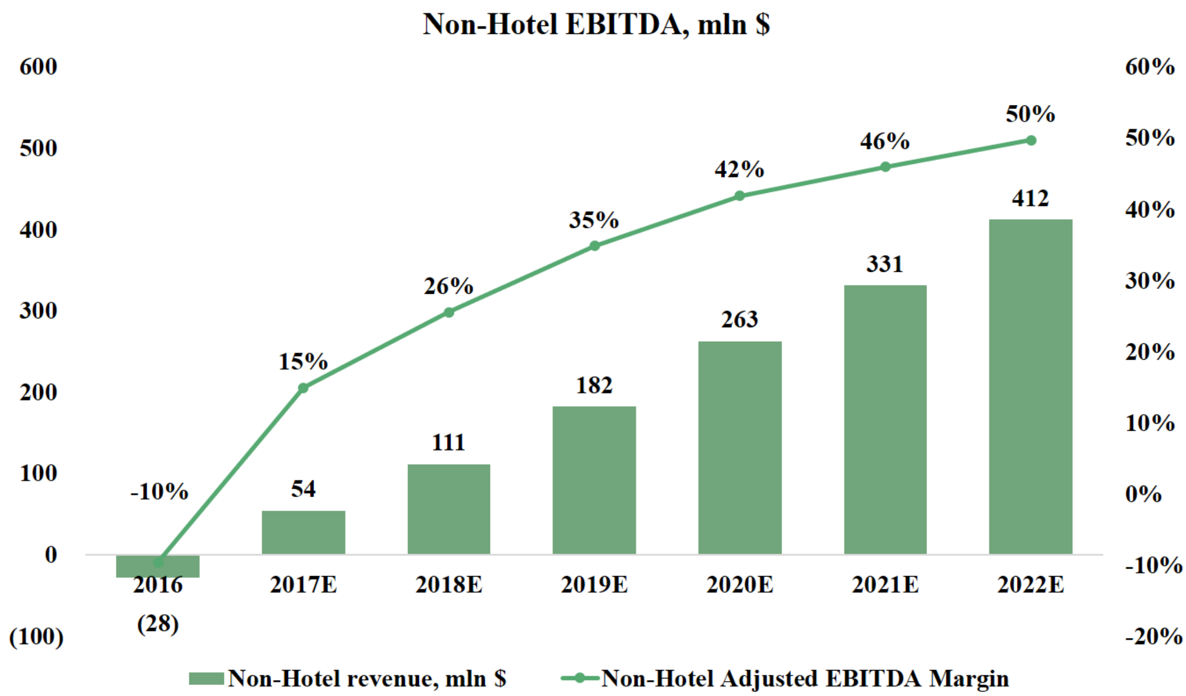


Source: TripAdvisor filings, Caro-Kann Capital research.

(b) Non-Hotel Adjusted EBITDA Forecast: Base Case

In our base case Adjusted EBITDA margins improve rapidly over the next few years and reach 50% by 2022.

TripAdvisor Non-Hotel Business: Adjusted EBITDA Forecast – Base Case



Source: TripAdvisor filings, Caro-Kann Capital research.

While 50% Adjusted EBITDA margins may sound too high right now, we would like to point out a few things.

First, in 3Q 2017 Attractions and Vacation Rentals together generated ~40%+ Adjusted EBITDA margins. This range of margins is *already* reality.

Yes, 3Q is the strongest quarter of the year and 3Q 2017 Non-Hotel revenue was ~ 30% higher than 2Q 2017. Yet, Non-Hotel costs grew only ~2.5% in 3Q 2017 compared with 2Q 2017. This means that 2Q 2018 can grow ~20% to 30% y-o-y while costs grow only ~5% or less. Such a combination of rapid revenue growth and modest costs growth would result in ~27% Adjusted EBITDA margins in 2Q 2018.

When we project similar dynamics over the next few years based on the strong operating leverage embedded in the business model, we get to a ~50% Adjusted EBITDA margin.

Second, OpenTable generated 40%+ EBITDA margins in North America in 2013. This is EBITDA margin after stock-based compensation while we are projecting Adjusted EBITDA margin for TripAdvisor Non-Hotel Business (*i.e.*, before stock-based compensation).

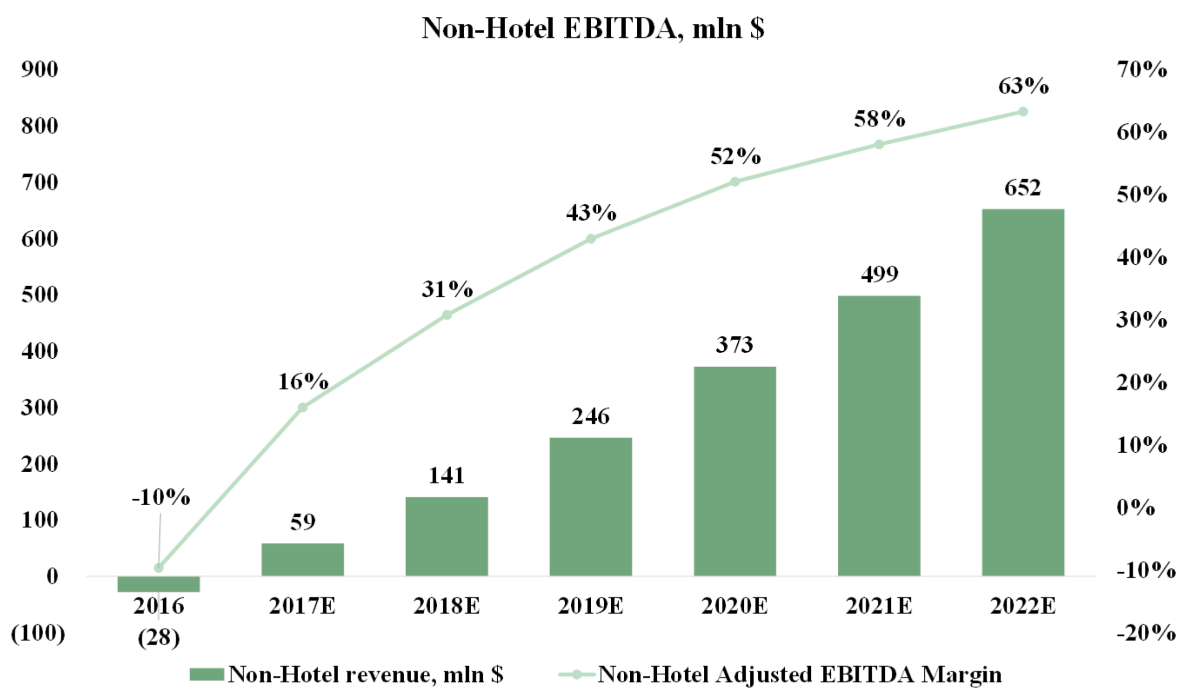
Third, we explained that Attractions should have better than OTAs' margins that are ~40% or higher.

Thus, we do not think that ~50% Adjusted EBITDA margin is out of the question in 2022 while we recognize that that may sound unbelievable right now (that's why the stock is $35!).

(c) Non-Hotel Adjusted EBITDA Forecast: Bull Case

In our bull case Adjusted EBITDA margins improve even more rapidly over the next few years and reach 63% by 2022.

TripAdvisor Non-Hotel Business: Adjusted EBITDA Forecast – Bull Case



Source: TripAdvisor filings, Caro-Kann Capital research.

Yes, 63% is indeed ambitious but this is exactly why we call it a *bull* case! We would also remind the reader that such higher margins would be achieved on a substantially higher revenue base which, coupled with strong operating leverage logically leads to higher Adjusted EBITDA margins.

XII. Non-Hotel Business: Valuation

We have done a valuation of Non-Hotel Business three and five years out – in 2020 and 2022 respectively.

1. Non-Hotel Business Valuation in 2020

We will present our base case here and our readers can perform similar valuation exercise for bear and bull cases as we presented all relevant date and described all key assumptions. Please also refer to Appendix for financial projections for all three cases.

In our base case 2020E Adjusted EBITDA is ~$263M.

We assume 2% share dilution per year due to ongoing stock-based compensation.

We also account for cash build up after CapEx (~5% of revenue in our base case) and taxes (30% global tax rate which may prove to be too conservative given The Tax Cuts and Jobs Act of 2017). TripAdvisor has a net cash position, so we do not model either interest expense or interest income.

We pick a range of multiples: 12x, 14x, and 16x. We strongly believe that the Non-Hotel business deserves a high multiple given that two of its businesses have incredible characteristics of dominant platforms.

This is our valuation for 2020.

Multiple Scenario	Adjusted EBITDA Multiple	Price per share, $	Cash build up per share, $	2020 total value per share, $
Low	12x	$21.37	$2.26	$23.64
Medium	14x	$24.94	$2.26	$27.20
High	16x	$28.50	$2.26	$30.76

Source: Caro-Kann Capital research.

2. Non-Hotel Business Valuation in 2022

Our methodology for our 2022 valuation is very similar to the 2020 valuation methodology.

We similarly increase the number of shares outstanding by 2% every year due to ongoing stock-based compensation.

We use the same range of multiples: 12x, 14x, and 16x.

This is our valuation result for 2022.

Multiple Scenario	Adjusted EBITDA Multiple	Price per share, $	Cash build up per share, $	2022 total value per share, $
Low	12x	$32.23	$5.21	$37.44
Medium	14x	$37.60	$5.21	$42.82
High	16x	$42.98	$5.21	$48.19

Source: Caro-Kann Capital research.

XIII. Non-Hotel Business Valuation: Concluding Thoughts

As you can see, our valuation of Non-Hotel business is between ~$23 and ~$48 per share 3 – 5 years out. You may also recall that we did a valuation of TripAdvisor Restaurants before and our range was ~$10 to $25 five to ten years out. You may wonder whether these valuation results are consistent with each other.

We would point out the following. These two valuation methodologies are different. In the ideal world, we would love to do a separate valuation of each subsegment of the Non-Hotel Business: Restaurants, Attractions, and Vacation Rentals. We were able to construct detailed valuation of Restaurants using OpenTable as a case study. However, we cannot do the same for Attractions and Vacation Rentals. You will recall that we did a rough valuation sketch for TripAdvisor Attractions (our valuation range is between ~$14 and $29) and did not do any valuation for TripAdvisor Vacation Rentals. Thus, we have to do valuation "in aggregate" for the entire Non-Hotel segment, which obviously has less granularity.

XIV. Hotel Business Valuation

1. Hotel Business: A Few Remarks

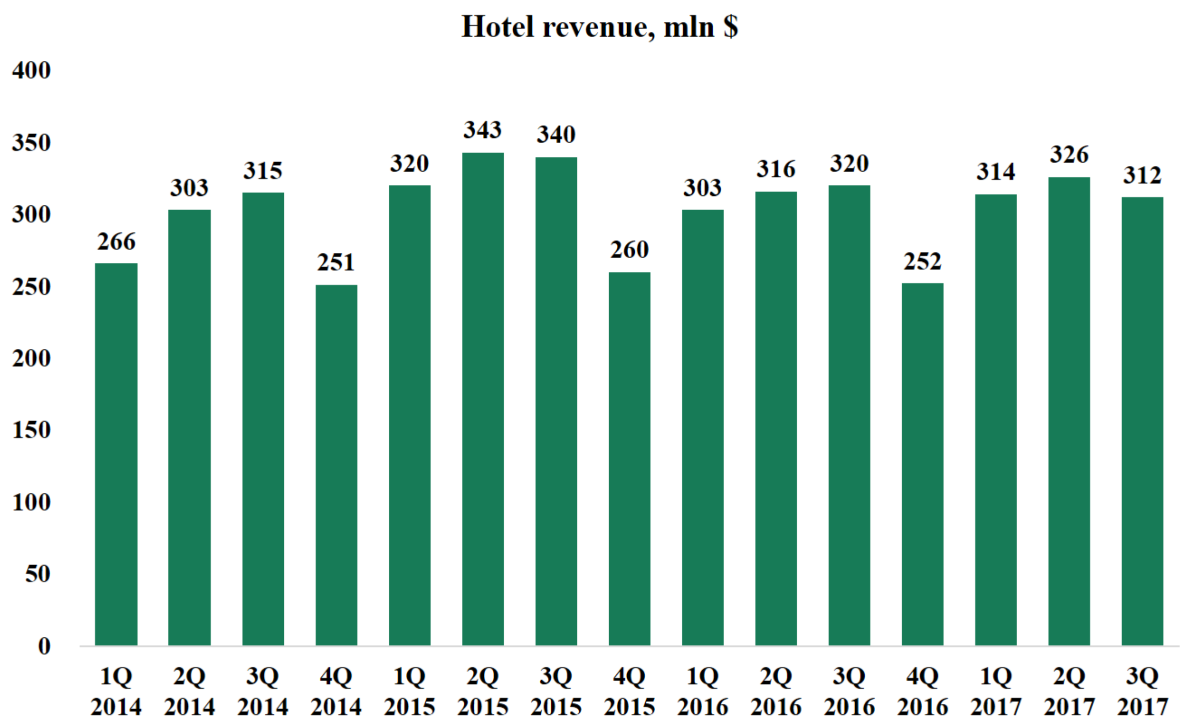
As we stated at the very beginning, our thesis is based on our deep analysis and understanding of the Non-Hotel Business and dynamics around platform businesses. This is *our edge*. We have not seen anybody approach TripAdvisor from this angle and we have not seen anybody who decoded the TripAdvisor Non-Hotel Business in such detail.

Our views on the Hotel Business are less important for our investment case. We also suspect that our views on the Hotel Business are less unique. However, we cannot just skip Hotel Business entirely in this investment memorandum. Thus, we will share our views on the Hotel Business but *we will intentionally keep them brief*. And no, we do not know what cost per click will be in 1Q 2017. And no, we do not know what Priceline will do with its bidding strategy.

2. Hotel Revenue Is Roughly Flat 3 Year Later!

TripAdvisor Hotel Business revenue has been roughly flat since 2014. TripAdvisor has nothing to be particularly proud of.

TripAdvisor Hotel Business Revenue: Roughly Flat 3 Years Later!

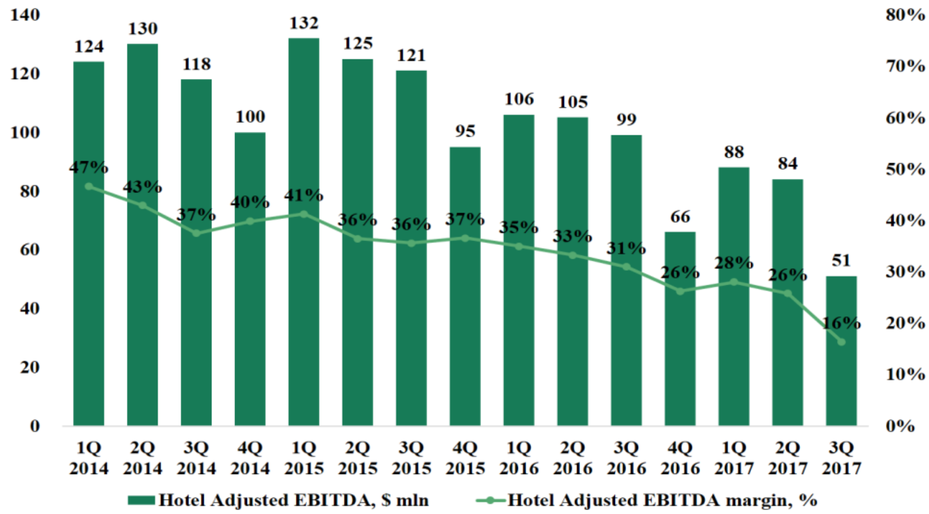


Source: TripAdvisor filings, Caro-Kann Capital research.

3. <u>TripAdvisor Hotel EBITDA Is Down ~55% in 3Q 2017 vs. 3Q 2014</u>

While Hotel revenue has been roughly flat, Hotel EBITDA has weathered much worse as Adjusted EBITDA margins collapsed.

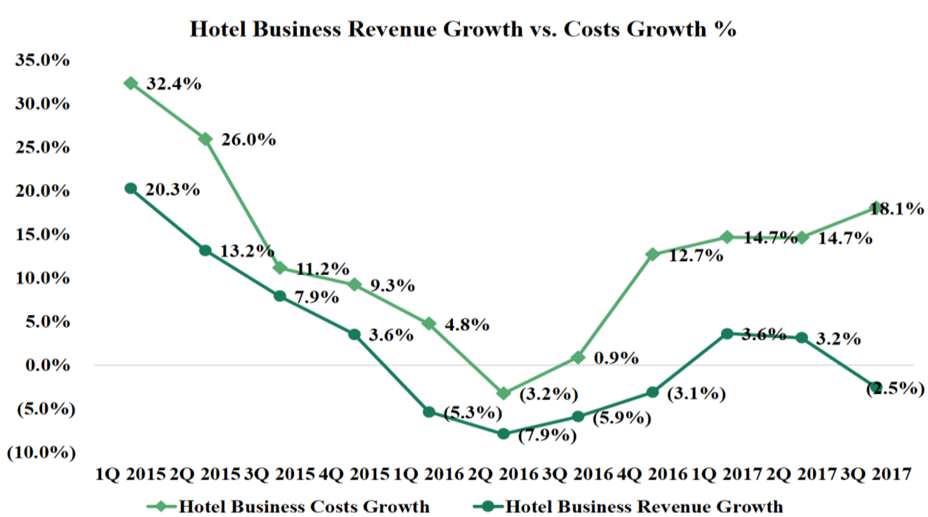
TripAdvisor Hotel Business Adjusted EBITDA: Down ~55% in 3Q 2017 vs. 3Q 2014!



Source: TripAdvisor filings, Caro-Kann Capital research.

Not surprisingly Hotel Business costs have grown faster than Hotel Business revenue *every single quarter* since 1Q 2015.

TripAdvisor Hotel Business: Costs Have Been Growing Faster Than Revenue Every Single Quarter Since 1Q 2015



Source: TripAdvisor filings, Caro-Kann Capital research.

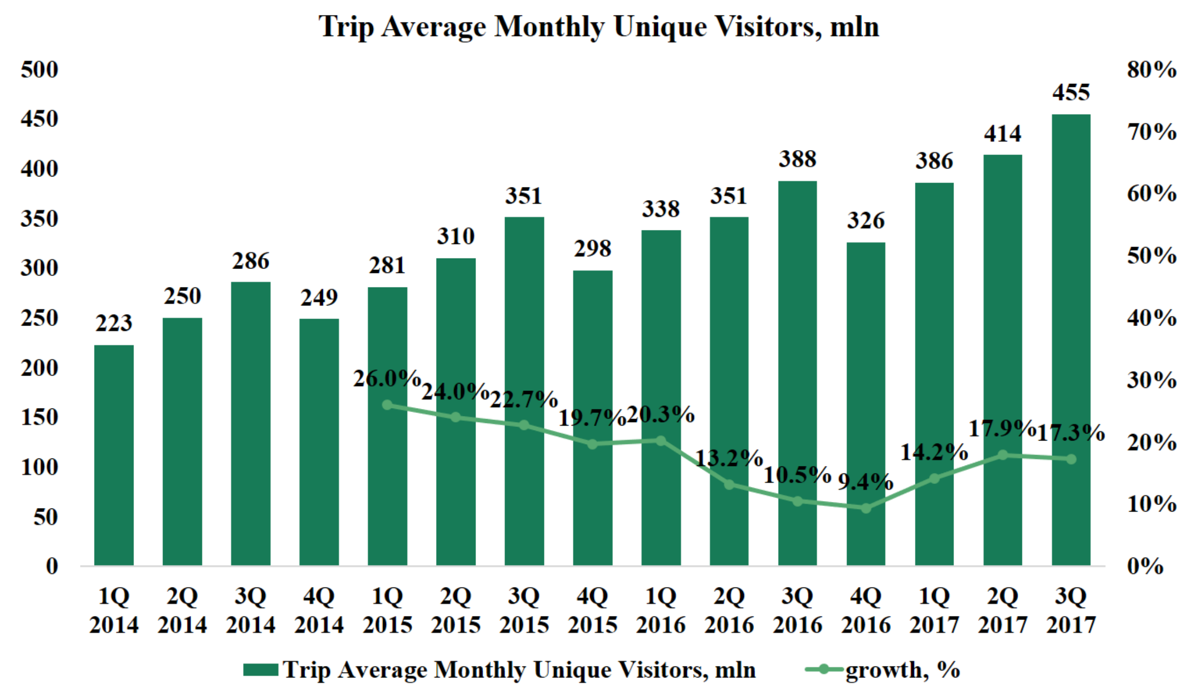
4. <u>Key Engagement Metrics Remain Incredibly Healthy in the Hotel Business</u>

Despite Adjusted EBITDA margins collapsing, we believe that, as Mark Twain is often *mis*quoted, the reports of TripAdvisor Hotel Business' death "are greatly exaggerated".

How do we know? We look at the most important metrics for any platform business (or probably any business for that matter): **customer happiness** and **customer engagement**.

First, TripAdvisor monthly unique visitors (both Hotel and Non-Hotel) have remained healthy and in fact have been growing.

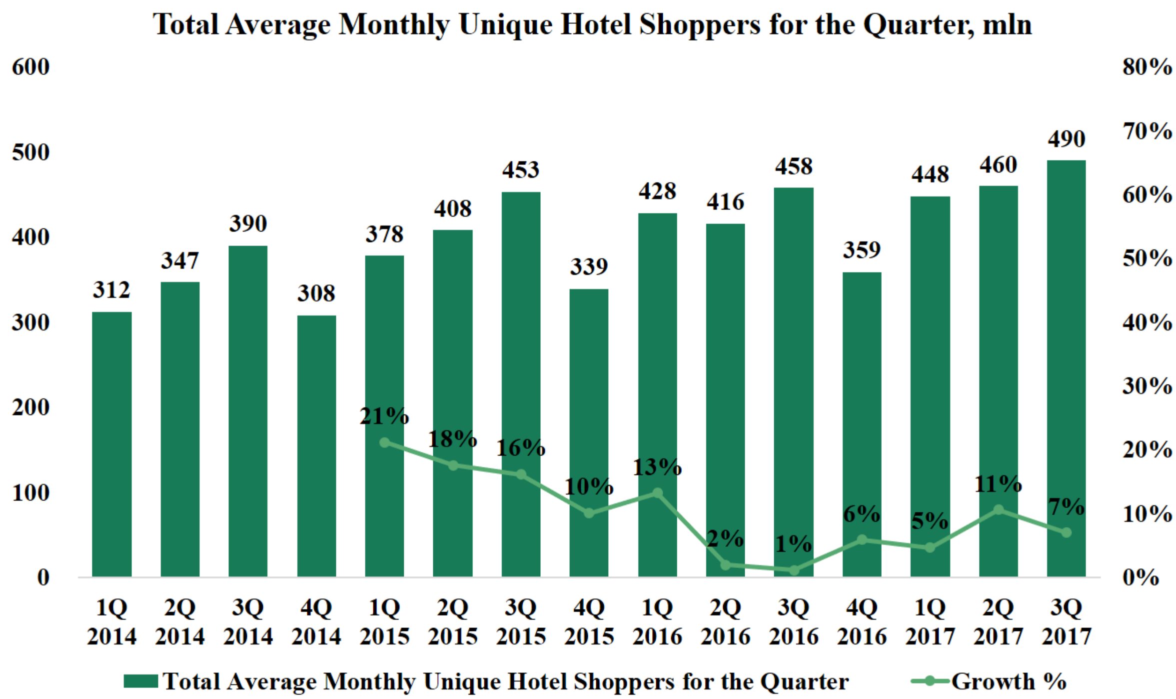
TripAdvisor Average Monthly Unique Visitors (Both Hotel and Non-Hotel) Have Remained Healthy and Have Been Growing



Source: TripAdvisor filings, Caro-Kann Capital research.

Second, total average monthly unique hotel shoppers for the quarter have been healthy and have grown as well.

TripAdvisor Total Average Monthly Unique *Hotel* Shoppers for the Quarter Have Been Healthy and Growing!



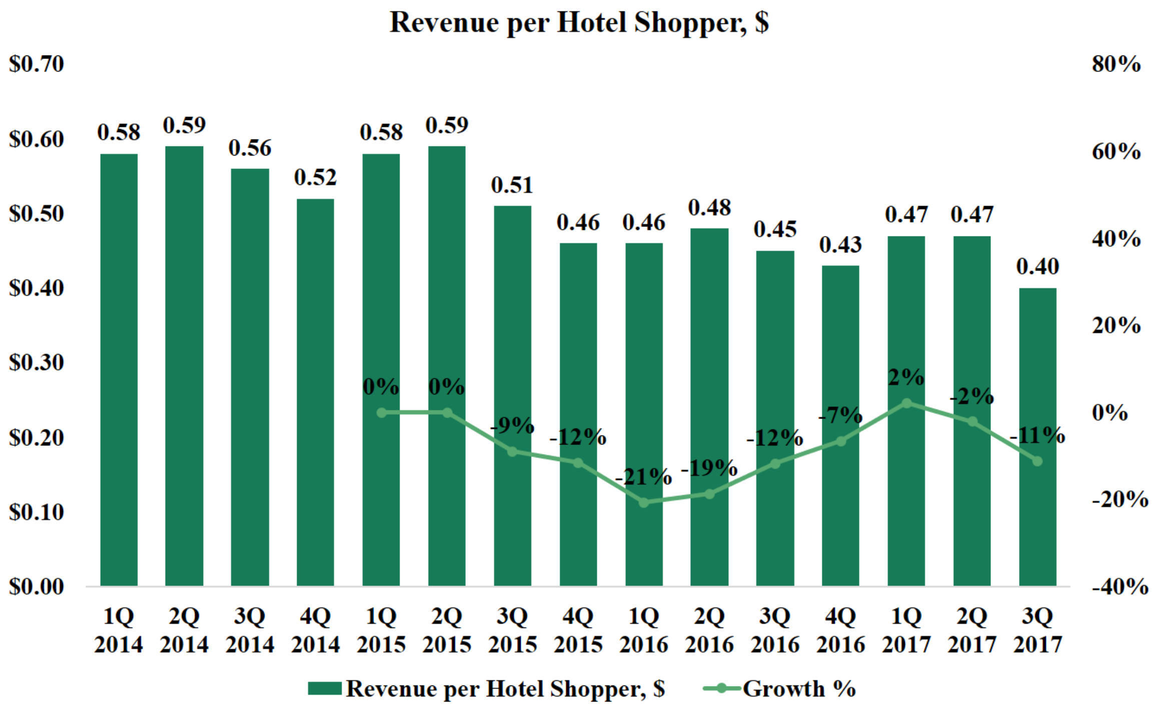
Source: TripAdvisor filings, Caro-Kann Capital research.

In our view, these customer engagement metrics are not metrics of a business that is going away.

5. <u>Falling Revenue Per Hotel Shopper Is at the Core of the Problem</u>

The roughly flat revenue accompanied by the growing number of hotel shoppers is explained by falling revenue per hotel shopper (*i.e.*, poorer monetization).

TripAdvisor Revenue per Hotel Shopper Has Decreased by ~30%



Source: TripAdvisor filings, Caro-Kann Capital research.

6. <u>What Is Behind Falling Revenue Per Hotel Shopper?</u>

At least three factors have contributed to the falling revenue per hotel shopper.

First, the failed Instant Booking initiative that was significantly curtailed in 2017.

Second, shift of traffic to mobile which monetizes only at ~30% to 35% of desktop monetization.

Third, cost per click in metasearch side of TripAdvisor Hotel Business has decreased.

7. <u>What Is Behind Increases in Hotel Business Costs That Have Been Increasing Faster Than Revenue?</u>

Similarly, there are a few contributing factors.

First, pressure from Google led to higher traffic acquisition costs.

Second, TripAdvisor re-launched its TV advertising campaign in 2017 which generates ROI with a substantial time lag – this is quite different from investing in performance-based marketing channels where you can see your ROI almost every minute. TripAdvisor spent ~$16M and ~$42M on TV advertising in 2Q 2017 and 3Q 2017 respectively. If we add back these long-term investments in TripAdvisor brand, then margins in the Hotel Business look significantly better.

8. Why Are We Not Concerned Long-Term About The Hotel Business?

Why are we not concerned about TripAdvisor's Hotel Business long-term? There are multiple reasons.

First, as we have pointed out, user engagement remains incredibly healthy.

Second, TripAdvisor can go (and it appears that it is doing exactly that) back to the metasearch model and cut back on Instant Booking or even eliminate it completely.

Third, TV advertising campaign will either benefit TripAdvisor long-term or will be cut down or eliminated completely.

Fourth, mobile is *the future*, and TripAdvisor mobile is doing incredibly well. Mobile is approaching ~50% of traffic. Mobile is growing incredibly fast (~20%). Finally, app traffic as per cent of mobile traffic is ~40%. App traffic has zero acquisition costs (no Google involvement!).

Fifth, margins in mobile should be better than in desktop because despite lower monetization mobile also has lower traffic acquisition costs.

Sixth, Priceline cutting on performance-based marketing is not disastrous. Let's go through this point in more detail.

If you are a supplier to Walmart and Walmart cuts you out, it will take time and effort to replace volume that you have been selling through that channel. You may not even find a replacement for all that volume, which will really hurt your business performance.

However, online metasearch auctions are radically different: if Priceline does not buy, someone else (Expedia, hotel chains, etc.) will! This means that while CPC prices may go down, the volume will not likely drop as long as hotel shoppers come to www.tripadvisor.com or use the TripAdvisor app. We have shown the numbers that confirm that hotel shoppers keep coming!

9. TripAdvisor Hotel Business: Valuation

It is very difficult to value the TripAdvisor Hotel Business because its recent profitability metrics have been depressed.

3Q 2017 LTM Adjusted EBITDA is depressed due to TV advertising. 2016 Adjusted EBITDA was depressed because of the failed transition to Instant Booking.

However, going back to 2015 and using 2015 Adjusted EBITDA is unlikely to be appropriate because the world was quite different back then.

There is no perfect approach here.

This is what we have decided to do. We are taking an average of 3Q 2017 LTM Adjusted EBITDA and 2016 Adjusted EBITDA. One can argue with this approach but, as we wrote, there is no perfect approach here.

The issue of multiple is not much easier. We view a 12x multiple appropriate given that we are applying it to depressed Adjusted EBITDA, business quality, and continuously healthy user engagement.

2016 Hotel Adjusted EBITDA, mln $	380.0
LTM Hotel Adjusted EBITDA, mln $	289.0
Average, mln $	**334.5**
Multiple	12.0x
EV, mln $	**4,014**
Value per Share, $	**$28.88**

We would highlight that this valuation assumes no substantial improvement in Hotel Business and, therefore, provides us with ***lots of upside optionality if such improvement happens***.

XV. TripAdvisor Valuation: Putting It All Together

We can look at TripAdvisor's valuation from multiple angles. We tend to think about it as a ***compounder that will generate ~15%+ IRR for many years (5 to 10 years)***.

Here is a bit more mathematical way but we do not want to get caught in a false sense of precision given that some of our estimates of intrinsic value for Non-Hotel Business in general and Restaurants in particular were fairly wide.

Non-Hotel Business is worth ~$43 in 2022 in our base case. We assume Hotel Business intrinsic value remains stagnant at ~$29, which is a very punitive assumption. Putting it together we get to ~$72 in 5 years compared to a current share price of ~$35. This results in ~100%+ upside and 15%+ IRR.

But what's about **upside optionality**? We think that we are getting plenty of it.

First, any substantial rebound in Hotel Business will make our expected return more lucrative. Second, we are assuming that cash will keep piling up on TripAdvisor's balance sheet. This assumption is close to ridiculous given that Liberty TripAdvisor owns ~30% of shares by economic value and ~57% of voting power and, as we all are aware, Liberty entities are masters of capital allocation and share buybacks. Using cash generated by the Non-Hotel Business *alone* TripAdvisor can buy back ~16% of shares outstanding. Third, as strange as this may sound, our projections for the Non-Hotel Business components may prove to be conservative. Please keep in mind that we have modelled fairly modest increases in bookable restaurants and attractions. We have relied on increased usage and increasing user engagement as major drivers. However, more robust growth in bookable restaurants and bookable attractions can lead to ***the lollapalooza effect***. Finally, as we have shown in separate TripAdvisor Restaurants and TripAdvisor Attractions valuation, each of those two subsegments alone may be worth up to $25 per share in five years or $50 per share combined.

XVI. Catalysts and Inflection Points

We see several catalysts and inflection points ahead of TripAdvisor that will likely help Mr. Market start to realize what this moody fellow is missing.

1. Continuous Increases in Profitability of Non-Hotel Business Will Become Too Hard to Ignore for Both Buyside and Sellside

Many sellside analysts have historically not modelled the Hotel Business and Non-Hotel Business separately; they have lumped them together and interpolated Hotel Business drivers to Non-Hotel Business. This started changing some time ago and now some sellside analysts have started breaking down the Hotel Business and Non-Hotel Business in their models. However, we have not seen thoughtful models that attempt to do a detailed valuation of the Non-Hotel Business.

We expect this to change once Adjusted EBITDA of Non-Hotel Business gets to the point where it is hard or even impossible to ignore. We think that this happen late in 2018 or mid-2019.

Buyside professionals are likely to pick up on this even sooner.

2. Rapid Growth in Non-Hotel EBITDA Will Lead to *Entire* Company Adjusted EBITDA Growth

Even if Hotel Business Adjusted EBITDA does not rebound, growth in Non-Hotel Business Adjusted EBITDA will make entire company Adjusted EBITDA growth turn positive. We think this will most likely happen in 2018. If the Hotel Business rebounds, then this will happen even faster.

3. Traffic Shift to Mobile Will Lead to Hotel Revenue and Hotel Adjusted EBITDA Growth

Continuous traffic shift to mobile and growing revenue per hotel shopper in the mobile channel will eventually lead to increases in mobile hotel revenue more than offsetting decreases in desktop revenue and the entire hotel revenue will start to grow. This may happen in 2019. Similarly, this will also lead to growth in Hotel Adjusted EBITDA.

XVII. Risks

We will point out two risks.

1. <u>What If Management Prioritizes Short-Term Over Long-Term …</u>

Building a platform business requires time, patience, commitment, and long-term thinking. Despite being heavily criticized due to the failure of Instant Booking, CEO Steve Kaufer has shown that he has those qualities by building TripAdvisor Restaurants and TripAdvisor Attractions. However, he was able to do that when Hotel Business was doing between "well" and "great" and he had the luxury to invest in these businesses for the long term.

We see a risk that under pressure from the Board of Directors / Liberty and Wall Street, TripAdvisor management may prioritize short-term profits in Non-Hotel Business over solidifying its leading position in those markets and expanding its network even further.

2. <u>What If A Strategic Buyer Acquires TripAdvisor</u>

It may sound odd that we are concerned about this but we truly are. If someone acquires TripAdvisor in the next 12 to 24 months (before the full potential of Non-Hotel Business becomes evident), we may miss out on a long-term compounder.

Appendix

1. Non-Hotel Segment Projections: Bear Case

In mln $	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Non-Hotel revenue	414	476	547	602	662
growth, %	*15.0%*	*15.0%*	*15.0%*	*10.0%*	*10.0%*
Non-Hotel pre-EBITDA costs	344	378	424	474	531
growth, %	*10.0%*	*10.0%*	*12.0%*	*12.0%*	*12.0%*
Non-Hotel Adjusted EBITDA	**70**	**98**	**124**	**127**	**131**
growth, %	*48.1%*	*39.6%*	*26.6%*	*3.1%*	*2.6%*
Adjusted EBITDA margin, %	16.9%	20.5%	22.6%	21.2%	19.7%
Incremental Non-Hotel revenue	54	62	71	55	60
Incremental Non-Hotel Adjusted EBITDA	23	28	26	4	3
Non-Hotel Incremental Adjusted EBITDA margin, %	42.1%	44.6%	36.4%	7.1%	5.4%
CapEx as % of revenue	7.0%	7.0%	7.0%	7.0%	7.0%
Non-Hotel CapEx	29	33	38	42	46
D&A	29	33	38	42	46
Assume D&A = CapEx					
Taxable income	41	64	85	85	84
Tax rate, %	35.0%	35.0%	35.0%	35.0%	35.0%
(Cash taxes due) / Refund	(14)	(22)	(30)	(30)	(30)
NWC changes	0	0	0	0	0
Unlevered FCF (ignores SBC as we are projecting share count increase)	**27**	**42**	**55**	**55**	**55**
Cash Build Up	27	68	124	179	234

2. Non-Hotel Segment Projections: Base Case

In mln $

	2018E	2019E	2020E	2021E	2022E
Non-Hotel revenue	436	523	627	721	830
growth, %	*20.0%*	*20.0%*	*20.0%*	*15.0%*	*15.0%*
Non-Hotel pre-EBITDA costs	324	341	365	390	417
growth, %	*5.0%*	*5.0%*	*7.0%*	*7.0%*	*7.0%*
Non-Hotel Adjusted EBITDA	**111**	**182**	**263**	**331**	**412**
growth, %	*105.8%*	*63.8%*	*44.3%*	*26.1%*	*24.4%*
EBITDA margin, %	25.5%	34.8%	41.9%	45.9%	49.7%
Incremental Non-Hotel revenue	73	87	105	94	108
Incremental Non-Hotel Adjusted EBITDA	57	71	81	69	81
Non-Hotel Incremental Adjusted EBITDA margin, %	78.7%	81.4%	77.2%	72.9%	74.8%
CapEx as % of revenue	5.0%	5.0%	5.0%	5.0%	5.0%
Non-Hotel CapEx	22	26	31	36	41
D&A	22	26	31	36	41
Assume D&A = CapEx					
Taxable income	89	156	231	295	371
Tax rate, %	30.0%	30.0%	30.0%	30.0%	30.0%
(Cash taxes due) / Refund	(27)	(47)	(69)	(89)	(111)
NWC changes	0	0	0	0	0
Unlevered FCF (ignores SBC as we are projecting share count increase)	**63**	**109**	**162**	**207**	**260**
Cash Build Up	63	172	334	540	800

3. <u>Non-Hotel Segment Projections: Bull Case</u>

In mln $

	2018E	2019E	2020E	2021E	2022E
Non-Hotel revenue	458	572	715	858	1,030
growth, %	*25.0%*	*25.0%*	*25.0%*	*20.0%*	*20.0%*
Non-Hotel pre-EBITDA costs	317	326	343	360	378
growth, %	*3.0%*	*3.0%*	*5.0%*	*5.0%*	*5.0%*
Non-Hotel Adjusted EBITDA	**141**	**246**	**373**	**499**	**652**
growth, %	*140.4%*	*74.4%*	*51.5%*	*33.8%*	*30.8%*
EBITDA margin, %	30.8%	43.0%	52.1%	58.1%	63.3%
Incremental Non-Hotel revenue	92	114	143	143	172
Incremental Non-Hotel Adjusted EBITDA	82	105	127	126	154
Non-Hotel Incremental Adjusted EBITDA margin, %	89.9%	91.7%	88.6%	88.0%	89.5%
CapEx as % of revenue	3.0%	3.0%	3.0%	3.0%	3.0%
Non-Hotel CapEx	14	17	21	26	31
D&A	14	17	21	26	31
Assume D&A = CapEx					
Taxable income	127	229	351	473	621
Tax rate, %	25.0%	25.0%	25.0%	25.0%	25.0%
(Cash taxes due) / Refund	(32)	(57)	(88)	(118)	(155)
NWC changes	0	0	0	0	0
Unlevered FCF (ignores SBC as we are projecting share count increase)	**95**	**172**	**263**	**355**	**466**
Cash Build Up	95	267	530	885	1,351

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