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Priceline.com, Inc. (NASDAQ: PCLN)

Initiating Coverage: **BUY**

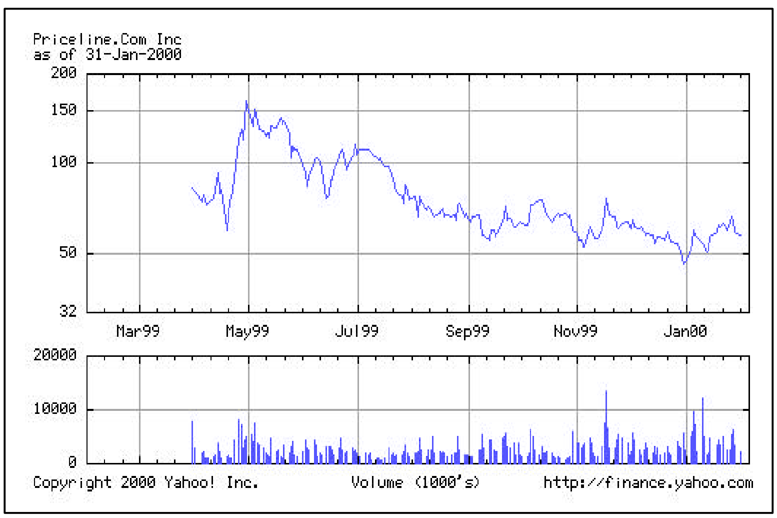
January 31, 2000

KEY CONSIDERATIONS

- The travel industry is expected to generate $32 billion in online sales by 2004.
- Priceline’s grocery service was rated the fastest growing e-commerce site ever by CBS Marketwatch.
- Prceline licensed its patent-protected technology to Net2Phone for $18 million.
- Priceline is still unprofitable and is expected to continue to incur substantial losses for the foreseeable future.
- Intense competition in the travel, automobile, mortgage, and consumer-to-consumer sales industries will challenge Priceline’s ability to retain existing customers and gain market share.

Recent Price	$59.63
52WK Low	$45.50
52WK High	$165.00
P/E	N/A
P/Book	39.09
P/Sales	16.61
Market Capitalization	$ 8730 mil
Shares Outstanding	146.43 mil
Float	19 mil
Daily Volume (3-month Average)	3.94 mil
EPS	
1998	*$-0.53*
1999E	*$-1.05*
2000E	*$-0.38*
Current Ratio	5.36
Total Debt to Equity	0.00
LT Debt	0.00
Total Cash	$192.9 million

ONE-YEAR PRICE AND VOLUME GRAPH



COMPANY PROFILE

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

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

THE COMPANY

Business Model. Priceline.com has pioneered a unique e-commerce pricing system known as a "demand collection system" that enables consumers to use the Internet to save money on a wide range of products and services while enabling sellers to generate incremental revenue. Using a simple and compelling consumer proposition – "name your own price" – Priceline collects consumer demand, in the form of individual customer offers guaranteed by a credit card, for a particular product or service at a price set by the customer. Priceline then either communicates that demand directly to participating sellers or access participating sellers' private databases to determine whether Priceline can fulfill the customer's offer on the basis of the pricing information and rules established by the sellers. Consumers agree to hold their offers open for a specified period of time and, once fulfilled, offers cannot be cancelled. Priceline benefits consumers by enabling them to save money, while at the same time benefiting sellers by providing them with an effective revenue management tool capable of identifying and capturing incremental revenues. By requiring consumers to be flexible with respect to brands, sellers, and product features, we enable sellers to generate incremental revenue without disrupting their existing distribution channels or retail pricing structures.

Priceline commenced operations in April of 1998. Since that time, Priceline has grown significantly; services now include the following products and services:

- *leisure airline tickets* provided by 8 domestic and 20 international airline participants;
- *new automobiles* to buy or lease, which has been expanded from the New York metropolitan area in July 1998 to 16 states now;
- *hotel room reservations* offers hotel rooms in substantially all major United States markets and includes more than 12 leading national hotel chains;
- *home financing services* with home mortgage services and home equity loans and refinancing services.
- *rental cars* with the top 5 name-brand car rental companies as suppliers;
- *groceries and other retail merchandise* – the Company's business model was licensed to Priceline WebHouse Club in return for royalties and equity warrants.

Sources of Revenue. Priceline recognizes and records revenues in a variety of ways depending on the product or service sold. With respect to Priceline's airline ticket and hotel room reservation services, the company recognizes as revenue the amount that it receives from the customer, net of taxes, and records as the cost of revenue the amount that it pays the selling airlines and hotels. With respect to Priceline's automobile service, the company earns a fixed fee from both the customer and the seller after the transaction is consummated. With respect to the home financing service, Priceline receives marketing fees equal to a percentage of the net revenue generated by the service, which is presently operated in conjunction with LendingTree, Inc. Priceline also generates revenue through adaptive marketing programs with third party sources, including airline ticket processing fees from consumers and ancillary reservation booking fees from the Worldspan reservation system for our booking of airline flight segments and hotel reservations through the Worldspan system. Consumer fees are payable and recognized only upon completion of successful transactions. Lately, Priceline has begun to license its patent-protected technology to other companies. In exchange for $18 million, Priceline licensed its technology to Webhouse in order to implement the "name your own price" grocery service.

Ancillary fees, in addition to the fixed fee revenue that Priceline receives (namely due to the company's automobile service), constitute approximately 8.3% of the company's total revenue. Priceline's airline ticket service is by far the most productive in terms of generating revenue, but it is also the most costly.

Recent Events. Priceline is rapidly expanding the number of services it offers. By the summer of 2000, the company expects to offer its grocery service name wide. In January of 2000, Priceline introduced its "Perfect Yard Sale" – a consumer-to-consumer marketplace where buyers can "name their own price" for used good sold by other consumers in their area. Priceline also expects to launch its credit card and long distance services, which will allow consumers to demand certain parameters for credit cards and rates for long distance phone calls.

INDUSTRY AND COMPETITION

The markets for the products and services offered on Priceline are intensely competitive. Priceline competes with both traditional distribution channels and online services Priceline faces a considerable amount of competition from both online e-commerce sites and offline merchants, which include travel agents, travel service providers, consolidators and wholesalers of travel products, car dealerships, mortgage brokers, and insurance brokers, among others.

Consider the following online competitors in these respective categories:

Primary Competitiors 1/31/99					
Competitive Factor	**Priceline**	**Expedia**	**Autobytel**	**Mortgage.com**	**Ebay**
Brand	*2nd only to Amazon in consumer recognition	**Currently receives over twice the traffic of Priceline	Has a market share of 45%	Largest and best-known mortgage site	Leader in consumer-to-consumer sales
Price	Competitive and flexible pricing	Competitively priced	Competitively priced	Not as competitively priced	A wide price range
Variety of Products	Diverse and expanding product line	Hotel and car reservations, flights, vacations	New cars, used cars, insurance, loans, auctions	Home mortgages, refinancing, second mortgages	Extremely wide variety
Uniqueness	Unique demand-driven commerce system	Affiliated with Microsoft	Allows customers to view live inventory of car dealerships nationwide	Acts as both an issuer of mortgages and a portal to other lenders	First major online auction site; has the largest market share

- These competitors also have some significant competitive advantages. For example, airlines, hotels, and other suppliers also sell their products and services directly to consumers and have established web sites. Internet directories, search engines, and large traditional retailers have significantly grater operating histories, customer bases, technical expertise, brand recognition and/or online commerce experience than Priceline. And while Priceline's patent-protected "name your own price" concept provides it with an unparalleled level of uniqueness – and thus making the company name easier to brand – the company still lags behind several key competitors in market share. Currently, sites such as Expedia and Cheap Tickets have a much larger market share than Priceline. According to Media Metrix, Expedia was the ninth most visited travel site in during the holiday season of 1999 (November 14-December 26). During this time period, Expedia received over 1 million unique visitors – over twice as many as Priceline. In addition, Expedia has over 7.5 million registered customers, in comparison with Priceline's 3 million travel customers. It should be noted, however, that the travel industry is expected to generate $32 billion in online sales by 2004 (for other e-commerce estimates see our other e-commerce reports).

Priceline experiences similar competition in the mortgage and automobile industries. Web sites such as Car Point and Auto Trader have managed to seize a large portion of the market. Car Point's affiliation with Microsoft, Auto Trader's merger with Auto Connect, and Autobytel's enormous market share provide Priceline with competition that is extremely powerful. The home financing industry also appears to be rife with competition, as more experienced and specialized sites like iOwn.com and Mortgage.com currently experience greater success in the industry than Priceline. And Priceline's latest addition, the "perfect yard sale" which allows consumers to sell used goods, faces an incredible amount of competition from Internet giants like Ebay, Amazon, and Yahoo!. In the grocery industry, however, Priceline experiences little sincere competition. This has helped to make Priceline's grocery service extremely successful.

STRATEGIES FOR GROWTH

Priceline's strategy for growth centers primarily on using strategic partnerships to quickly enter many industries and seize control of the market. Thus far, Priceline has established key relationships with the five major American airlines, Travelocity and Preview Travel, Ford Motors, Lending Tree, and Webhouse. In 2000, Priceline hopes to establish relationships with Budget Rent-A-Car and National Car Rental System (car rentals), Net2Phone (long distance phone call company), and First USA Bank (issuer of credit cards). Priceline's partnerships have often proven to be rather costly; the company has issued stock valued in excess of $100 million to certain airlines for agreeing to work together. Through these key partnerships, Priceline has managed to develop a customer base of 3 million in less than two years in addition to selling an average of 50,000 plane tickets a week.

In conjunction with strategic partnerships, Priceline's strategy for growth relies on the rapid addition of new services in order to help brand the company name and further popularize existing services. Thus far, this strategy seems to be fruitful; in the same week that Priceline's grocery service had its first 10,000-customer day, its airline and hotel services it 7-day records. This gives credibility to the Priceline business model, which relies on the use of new services to generate revenue for pre-existing services. In addition, opinion polls also indicate validate the Priceline belief that additional services will help to brand the company name; a recent survey reported that Priceline was the second most recognizable e-commerce site, surpassed only by Amazon -- a site that also works diligently towards branding through the addition of new products and services.

While Priceline's strategy for quickly adding services seems to be successful, it is also extremely costly. Priceline will incur substantial expenses and use significant resources in trying to expand the type and range of the products and services that they offer. For example, Priceline has entered into an agreement to expand the Priceline.com service to include rental cars and long distance phone service. Expansion into these and other areas utilizes management resources and requires expenditure of significant funds, particularly in areas such as technology and marketing. In addition, if a Priceline service is poorly perceived by the public, it could result in a decreased market share for all Priceline services.

Priceline's growth is also dependent upon its ability to patent its intellectual property. Priceline's innovative patents currently make it extremely difficult for other companies to effectively enter the "name your own price" market, a market that employs a buyer-driver commerce system. The patents can also be licensed to generate revenue; Priceline licensed patents to Net2Phone in exchange for a payment of $18 million. It seems as though Priceline will continue to rely heavily on maintaining control over its intellectual property; the company currently has 25 patents pending in the United States.

We believe that the Priceline strategy for growth is effective. Through maintaining control of its intellectual property, Priceline has managed to preserve its uniqueness – thus further enabling the branding of the company name – in addition to striking lucrative licensing deals. Strategic partnerships have allowed the company to enter various industries rapidly while gaining a considerable portion of the market. Lastly, the new services that are being added have proven to work towards further increasing the prominence of other Priceline services.

Alliances and Partnerships

An important factor in Priceline's popularity is its strategic partnerships. The company has used partnerships to effectively compete with powerful and well-established companies in addition to achieving and maintaining a state of rapid development. Consider the following partnerships Priceline has made:

Airlines

Priceline's direct partnerships with over 28 airlines has proven to be extremely successful for all parties involved. Priceline's airplane tickets continue to soar at rapid rates; in 1999, the company reported ticket sales in excess of 700,000. The airlines also benefit, as they only allow Priceline to sell tickets on planes that are not completely filled. Through these partnerships, airlines are capable of selling their excess inventory at a small profit, while Priceline generates revenue and builds customer loyalty.

Priceline does, however rely heavily on its five largest airline suppliers; they accounted for approximately 90% of Priceline's airline ticket revenue for the nine months ended September 30, 1999. As a result, Priceline is currently substantially dependent upon the continued participation of these five airlines in order to continue to increase the company's overall airline ticket revenue. These partnerships can be terminated in a relatively short amount of time by either party. While this should raise some concern, it is unlikely that airlines will leave, since they too benefit from Priceline's services. In addition, a recent partnership with Delta Air Lines requires Priceline to obtain the permission of Delta prior to officially partnering with new airlines. This too should be of little concern, since Priceline currently is capable of working with a considerable number of airlines to find flights to virtually any domestic airport. Ultimately, we believe that Priceline's partnerships with airlines will prove to be extremely profitable.

LendingTree.com

Priceline currently relies on the superior computer systems of LendingTree, Inc. in order to implement its "name your own price" service to home mortgages. Lending Tree's own popularity and its familiarity with the mortgage industry make it an ideal computer system service for Priceline. The agreement between Priceline and LendingTree is terminable upon short notice; in the event that such a termination occurs, Priceline may experience difficulty in finding a suitable replacement.

Net2Phone, Webhouse, First USA Bank, Budget Rent-A-Car, National Car Rental Systems, Ford Motor Company

In order to increase its revenue in an entirely new manner, Priceline began to license its intellectual property and patented rights to other companies. Priceline first licensed its products to Webhouse, which worked towards launching the extremely successful Priceline grocery service. Priceline then licensed its patents and intellectual property to Net2Phone for $18 million. Through strategic licensing arrangements, Priceline has managed to implement another revenue source to its model, in addition to exacerbating the rate at which it can add new services. Just in the year 2000, Priceline plans to allow consumers to "name their own price" for long distance phone calls, car rentals, and credit cards. Such rapid growth can partially be attributed to these licensing agreements. While the licensing agreements are expected to last for a lengthy amount of time, patent challenges and the development of new technology and intellectual property may enable companies to effectively end their relationship with Priceline and decrease the company's market share and presence. Ultimately, however, we believe that Priceline has licensed its intellectual property wisely to reputable companies and thus will reap great rewards in the future.

AT&T

Priceline recently announced a marketing agreement with AT&T, which is expected to increase the customer base of both companies. Under the agreement, AT&T will participate in Priceline's sponsor dollars program, a feature that has been extremely popular among Priceline users; it allows them to save money on a variety of deals sponsored by participating companies. In addition, Priceline will be featured as a content provider for AT&T's WorldNet Service, a feature that reaches 1.8 million people. This marketing partnership with AT&T will surely increase Priceline's traffic and help to brand the company name.

The strategic alliances/partnerships established by Priceline have enabled the company to brand its name and rapidly add quality services that are very popular with the public. But because Priceline is highly dependent upon such relationships, it is extremely important that the partnerships be maintained in a positive and beneficial manner.

KEY RISK FACTORS

- The company has a limited operating history and is in the early stages of development.
- The company has incurred losses since its inception and anticipates continuing to incur substantial losses for the foreseeable future.
- The company has key relationships that can be ended at any time with little notice.
- The company may not be able to keep up with the continuous technological change in the Internet industry.
- The company faces intense competition in nearly all of the industries in which it participates.
- The company has grown significantly in a short period of time. Priceline may be incapable of continuing this growth rate or effectively managing its growth.
- The company is dependent upon the continued success of certain industries in which the company offers services, in addition to being dependent upon its partners. Currently, Priceline is especially dependent on its participating airlines and the airline industry as a whole.
- The company's business model, a reverse auction in which consumers can "name their own price," is novel and unproven.
- The company needs to expand its product and service line if it wishes to become profitable. This expansion is costly; furthermore, it may prove to be unprofitable and unpopular. If this is the case, then Priceline's other product and service lines will also so suffer do to negative association.
- There is intense competition due to low barriers of entry into the market; this could limit the company's market share.
- The company is highly dependent upon its key personnel, a staff of experienced individuals with a diverse background. Finding adequate replacement for such personnel, if this need ever arose, would be extremely difficult.
- The company is dependent upon third-party systems. Any interruption in these third-party services, or a deterioration in their performance, could be disruptive to Priceline.
- The company's success is dependent upon its ability to protect its intellectual property through patents. Priceline's intellectual property can be licensed -- thus creating another source of revenue – and is also a key part of maintaining the company's dominance in the "name your own price" market.

FINANCIALS

Revenue. Priceline derives its revenues from allowing consumers to "name their own price" on various goods and services supplied by other vendors. Priceline attempts to sell excess inventory of its participating vendors, thereby allowing consumers to obtain products and services well below the typical market value while allowing vendors to gain additional revenue and eliminate excess inventory. Furthermore, Priceline licenses many of its patents; these patents have grown in demand and value. As Priceline continues to add more service and promote itself aggressively, we believe that its revenue will increase sharply (see Income Statement below).

Gross Profit. Priceline's gross margin is expected to increase. The final quarter of 1999 marked a period of noticeable improvement in the company's gross margin and a substantial increase in the number of customers. This trend is expected to continue, as Priceline begins to offer more services (in addition to further developing current product lines), establish strategic alliances that will increase the site's reputability, and continue to license its patent-protected technology.

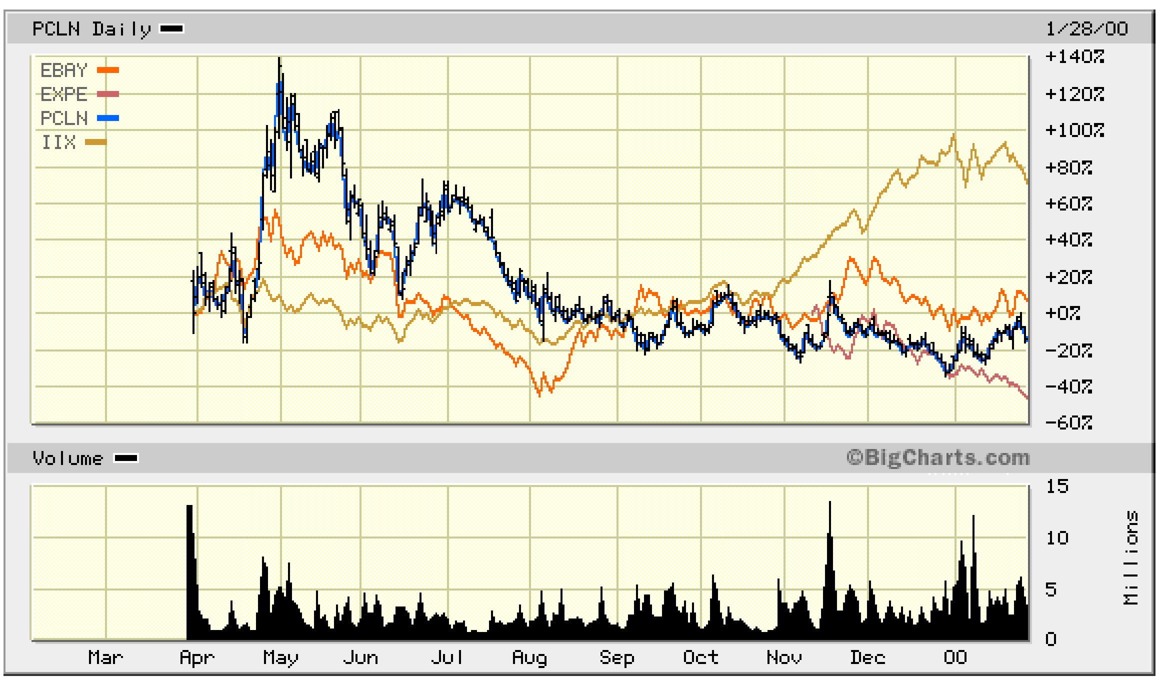
Research & Developent. Priceline is currently in the process of overhauling its infrastructure in order to support its anticipated growth. Because of this, we expect that the company's R&D expenses will rise. Still, Priceline's expansion in the number of products and services it offers – in addition to its rapidly increasing customer base – leads us to conclude that its revenue will increase at a greater rate, thus causing the R&D margin to decrease.

Sales and Marketing Margin. Priceline plans to increase its marketing budget in 2000. As the company develops its product line and expands into new markets, it will become necessary to spend a substantial amount on advertising. In late December, the company launched its national television advertising campaign, one that is expected to continue well into 2000. This expenditure, however, should be offset by a larger increase revenue. Because of this, we expect Priceline's sales and marketing margin to decrease slightly.

Net Income. Priceline is currently operating at a substantial loss. The company does not expect to become profitable until some time in 2001. Considering the increasing expenditures in sales, marketing, product development, and development, we believe that this is an accurate assessment.

Cash. Priceline currently has approximately 190 million dollars in cash. Considering the fact that the accompany continues to decrease its losses and expects to be profitable in 2001, it is most likely that this amount should be sufficient. Furthermore, the company does not carry a substantial amount of short-term liabilities (its current ratio is greater than five).

VALUATION



Value Comparison 1/31/00								
Company	***$ Price***	***Market Cap. In millions***	***Key Metric***	***P/S***	***Price to Key Metric***	***Gross Margin***	***Relative Strengths***	***Relative Weaknesses***
Priceline	59.625	8730.71	1 million offers per quarter	16.61	.00001661	10.04	Well Branded	Unproven revenue model
Ebay	147.5625	19085.65	5.3 million users	113.96	.0000215	77.09	Large and loyal customer base	High risk for consumers
Expedia	29	1107.80	7.5 million users	19.98	.00000266	62.14	Largest market share in the travel industry	Limited product line
Autobytel	12.38	225.37	2272 auto dealers	4.83	.00545	100	Much larger automobile product line	Offers automobile services only
Mortgage.com	5.75	247.18	4,459 loans per quarter	1.59	.0012895	-75.1	Largest market share in mortgage industry	Not competitively priced

Internet Sector. Although Priceline's stock has underperformed the Internet industry average for quite some time, the value of the stock is currently on the rise. It is currently performing better than Expedia (EXPE), one of its main competitors, but still lags behind Ebay (EBAY).

Price to Sales. The Price to sales ratio of Priceline.com is below the industry average. Considering the company's growth rate, its increasing market share and expected increase in gross margin, we believe that Priceline is slightly undervalued.

Margins. Priceline has relatively low gross margins. As a site that relies on e-commerce rather than advertising for its revenue, this is normal. Priceline's unique consumer-driven market, however, may allow it to succeed with such low margins. In addition, once Priceline is further developed, its product costs will drop – thus increasing its gross margin.

Investment Opinion. Priceline's strategy for growth and its unique "name your own price" commerce system appear to be successful. Through strategic alliances, the company has been capable of offering superior service in a variety of industries. In addition, Priceline's patent-protected technology allows the company to maintain its uniqueness while gaining revenue through strategic licensing. Although, Priceline does have a considerable amount of risk associated with it, and the company is still highly unprofitable, we believe that its stock is fairly valued and should appreciate in line with Priceline's sales growth in the future. For these reasons, we give Priceline a BUY rating.

INCOME STATEMENT (in $ except number of shares, margins and growth rates)

	FY97	FY98A	FY99E	FY00E
Revenue				
Revenues	0	21,604,165.00	481,000,000	930,000,000
Cost of Revenues:				
Products Costs	0	22,335,750	427,951,680	535000000
Supplier Warrant Costs	0	0	11,142,277	2,200,000
Total Cost of Revenues	0	22,335,750	439,093,957	537,200,000
Gross Profit	0	-731,585	41,906,043	392,800,000
Expenses				
Expenses:				
Supplier start-up warrant costs		0	98,389,011	82750000
Sales and Marketing		20,702,631	66,426,621	280000000
General and Administrative	513,000	18,458,259	20,851,954	41,000,000
Systems and business develc	2,000,000	10,619,679	10,603,048	25,000,000
Total Expenses	2,513,000	49,780,569	196,270,634	428,750,000
Operating Profit	-2,513,000	-50,512,154	-154,364,591	-35950000
Interest income, net	0	395,536	6,166,878	14000000
Net Profit	-2,513,000	-50,116,118	-148,197,713	-49950000
Earnings Per Share	0	-0.53	-1.05	-0.38
Weight Average Common Shar	N/A	81,720,566	139816683	165000000
Margin Analysis (% of revenue)				
Gross Margin	0	-3%	9%	42%
Sales & Marketing	0	96%	14%	30%
General & Administrative	0	85%	4%	4%
Research & Development	0	49%	2%	3%
Operating Margin	0	-234%	-32%	-4%
Net Margin	0	-232%	-31%	-5%
Growth				
Total Revenue	N/A	NM	2126%	93%
Gross Profit	N/A	NM	-5828%	837%
Operating Expense	N/A	1881%	294%	555%
Operating Income	N/A	-2110%	-406%	77%
Net Income	N/A	-2094%	-196%	-66%
Fully Diluted EPS	N/A	NM	98%	-64%