GRANT'S
INTEREST RATE OBSERVER®
Vol. 40, No. 12c | 233 Broadway, New York, New York 10279 • www.grantspub.com | JUNE 24, 2022

Air mattress deflates

Evan Lorenz writes:

Pandemically liberated America will likely make this summer one to remember for the travel industry. What a 401(k)-depleted America is likely to do in the months and years that follow is the question before the house. In preview, *Grant's* is bearish on Airbnb, Inc. (ABNB on the Nasdaq).

Shorting the home-sharing giant may not be in your immediate investment plans, but the analysis below applies to any business that thrives on consumer confidence and wilts in the lack of it. On this score, the University of Michigan's preliminary June consumer-sentiment survey slumped to 50.2, the lowest reading since the poll's inception in November 1952, and the economic-expectations component of the National Federation of Independent Business's small-business survey collapsed to negative 54 in May, the lowest in the series's 48-year history.

Consumers are shifting their spending from goods to services, which is leading to surging prices for services but falling ones for merchandise. Thus, in the CPI for May, measured year over year, the "lodging away from home" segment climbed by 19.3% while air fares soared by 37.8%. Rising energy costs played their inflationary part, but so, too, did wages. In general, the service sector is understaffed relative to the bounceback in demand. As for hotels and motels, they employed 19.3% fewer people in April than they did at the end of 2019, according to the Bureau of Labor Statistics.

Meanwhile, inventory-clogged Target Corp. is slashing prices on big-ticket items like TVs. On June 16, Samsung Electronics Co., Ltd. halted new procurement orders and delayed or reduced component shipments, Nikkei reported; bulging inventories were the culprit. As recently as May, Samsung gave its suppliers the all-clear signal for the rest of 2022.

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The genesis of Airbnb was an October 2007 conversation between San Francisco roommates Brian Chesky and Joe Gebbia. Why not, one asked the other, rent out an air mattress in your living room to earn some extra money? The duo joined forces with a third co-founder, Nathan Blecharczyk, in 2008 to launch AirBed & Breakfast. In that election year they made more money by selling Airbnb-created breakfast cereal (Obama O's and Cap'n McCain's) than renting out spare rooms.

However, the plucky young entrepreneurs secured an investment from tech incubator Y Combinator in January 2009. "If you can convince people to pay $40 for a $4 box of cereal, you can probably convince people to sleep in other people's airbeds," Paul Graham, a co-founder of Y Combinator, told Chesky, according to a Feb. 21, 2017 *Wired* article. "Maybe you can do it."

They did it. Airbnb today is the global leader in the very "alternative accommodation" lodging category that Chesky and Gebbia invented. As of March 31, 6 million homes, or parts thereof, were listed on the platform, along with activities and guided tours provided by the landlords, or "hosts." In the first quarter, customers, or "guests," booked 102.1 million days' worth of stays and experiences. It was the first $100 million-plus quarter in company history.

Airbnb has diversified as fast as it has grown, such that, in the first quarter, stays booked outside the 50 states contributed 48.8% of all revenues. According to the latest 10-K report, no one city accounted for more than 1% of revenues.

In the first eight weeks of the pandemic, CEO Chesky told *Barron's* in a July 26, 2021 interview, "business dropped 80%." Socially distanced customers demanded refunds in excess of $1 billion, which the company duly paid, and it distributed $250 million to its high-and-dry hosts. Neither disbursement was strictly obligatory. Twenty-five percent of the Airbnb workforce got its walking papers, although, said Chesky, "if you include attrition, we lost almost 40% of our employees."

But stimulus-enriched city dwellers, opting for full-home rentals in the burbs and ex-burbs, led a soaring recovery. "We started promoting long-term stays of more than 28 days, which grew from 14% of our business in 2019 to now 24%–25% of nights booked," Chesky told *Barron's*. "By the summer, we had a leaner cost base, we were more focused, our best people were working on the most important problems, and decisions were much faster. We had adapted faster than any other company in travel."

And they were richly rewarded for it. Airbnb's revenue leapt by 77.4% in 2021, to $6 billion, versus a prior peak of $4.8 billion in 2019. The leaner cost base helped to deliver $1.3 billion in adjusted Ebitda last year versus a deficit of $305.3 million in 2019, and business continues to boom. "As of the end of April 2022," said the May 3 earnings release, "we had 30% more nights booked for the summer travel season than at this time in 2019, and the growth from 2019 is higher the further we look out this year."

Nor is inflation likely to reduce vacation spending, says Bernstein Research analyst Richard Clarke. It's his contention that travel spending is essentially a luxury good. In 2019, he finds, the top 20% of earners accounted for 54% of hotel and lodging-out-of-town spending: "[T]his means that holiday spend is unlikely to be much impacted by rising fuel costs as the higher income consumers continue to be able to spend on travel."

Airbnb employees encounter no resistance from Chesky over the nationally fraught question of working from home. It's the WFH revolution, as the boss knows full well, that created the surge in long-term rentals. On Jan. 18, the founder announced that he would become an itinerant Airbnb guest this year, moving to a new town or city every few weeks. "Why am I doing this?" Chesky tweeted. "I think the pandemic has created the biggest change to travel since the advent of commercial flying. For the first time, millions of people can now live anywhere." On April 28, the boss informed the staff that they, too, could work from anywhere.

At the March 31 statement date, Airbnb carried $2 billion in debt against a cash balance of $6.9 billion. The unrated ABNB senior unsecured zero converts of 2026 change hands at $83.18 for a yield of 5%, or 337 basis points over Treasurys, which implies a double-B rating. While the first quarter delivered an operating loss of $5.1 million, operating income adjusted for share-based compensation covered interest expense by a factor of 40.

Out of the 41 equity analysts who opine on ABNB, only four say sell, and the short interest is immaterial. Since the start of the year, insiders have sold 4.1 million shares for proceeds of $596 million.

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Certainly, at 7.2 times enterprise value to the Street's guess for 2022 revenues and 24 times estimated Ebitda, much of the good news is discounted in the share price, the recent selloff notwithstanding. For comparison, online travel agent Booking Holdings, Inc. trades at 4.4 times 2022 sales and 14.4 times this year's Ebitda; Expedia Group, Inc., at 1.7 times 2022 sales and 7.7 times the Ebitda guesstimate.

Big expectations explain the ABNB valuation premium. Revenue growth, which rang the bell at 37.7% in 2022, is tipped to come back down to Earth at a still-elevated 19% in 2023 and to be followed by 19.6% in 2024 and 15.9% in 2025. All of which implies that 2025 revenue will be almost triple 2019's level.

Yes, agrees Seth Borko, a senior research analyst at travel-intelligence media company Skift, affluent consumers do generate the bulk of travel spending, but that fact doesn't nullify the economic cycle. "The wealth effect of a falling stock market is probably far more impactful to these people than the inflation is," Borko tells me. "Ironically, the S&P in a bear market arguably curtails spending as much as or more than inflation at 8%. The people being pinched by inflation at 8% didn't travel anyway, but the people whose 401(k) is down $50,000 did."

Because consumers book airline tickets and hotel reservations months before they pack their bags, falling asset prices will make their inhibiting mark with a lag. However, Skift, which queries approximately 1,000 consumers each month about their travel plans, is beginning to see signs of a slowdown. Thus, about the same proportion of respondents in June (34%) as in January (31%) said they would increase spending, but 25% of respondents in June indicated that they plan to cut spending while 17% had said so at the start of the year.

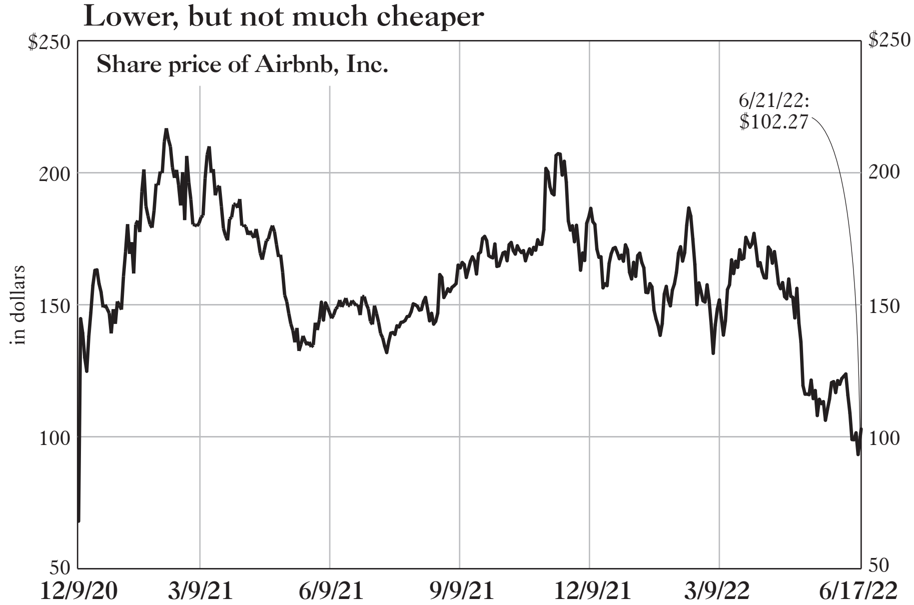
Jefferies, LLC, too, surveys consumers, and its latest canvass finds that 53% of respondents intend to reduce outlays on restaurants, 40% on travel and around 33% on luxury purchases. (For more on restaurants and luxury, see the issues of *Grant's* dated April 15 and May 13, respectively.)

Arbor Research & Trading, LLC, which studies the entrails of Google searches, draws similar inferences about consumers' spending intentions. "Pretty much starting in April, most consumption searches started declining and even more so through May," Arbor data scientist Anthony Rizzo tells me. "It really got hit hard. All signs to me are screaming that spending is going to slow down."

As for Airbnb, success creates its own burdens. On June 14, a series of tweets about a creepy hidden camera in an Airbnb rental went viral. What propelled it to virality was not so much the scandalous act as the omnipresence of the Airbnb brand.

Corporate prominence, too, tends to turn up the volume on customer complaints, including, in Airbnb's case, re-

Lower, but not much cheaper



source: The Bloomberg

sentment over the rise in average daily room rates, to $168.07 in the first quarter from $112.63 in the fourth quarter of 2019. Surcharges for cleaning fees are a particular sticking point, given that "hosts" expect "guests" to clean up after themselves.

Size itself chips away at the bullish case on ABNB. To hit Street expectations for growth, the company's rental base must keep expanding, which means that the residential-housing stock must keep growing—a contingency that is out of the hands of the Airbnb front office. According to the May 17 edition of the online publication Curbed, New York City residents are offering more short-term rentals than there are apartments available for rent in the city.

The sheer popularity of the Airbnb business model is taking its toll in places far from Manhattan. For example, in scenic Kangaroo Valley, New South Wales, according to *The Guardian* Australia, 76 homes are listed on sites like Airbnb's while the number of residential leases on offer is exactly one. Local politicians from Australia to Scotland are starting to ask where the non-tourists—and the employees who work at the businesses that serve the Airbnb-hosted tourists—can lay their heads at night.

Airbnb claims that the vast majority of its hosts are individuals who, mimicking the company's young founders, rent out a spare room or a second home to earn extra income. Skift checked out that contention late in 2020 and found that non-professional hosts did, in fact, make up 90% of total hosts in 2019, but that that wasn't the entire story. Hosts with a single listing made up only 43% of bookings. Small hosts with multiple listings accounted for 28%, and professional landlords for the remaining 29%.

Airbnb's growth, combined with ultra-accessible mortgage credit (remember that?), spawned a new class of real estate entrepreneur. Chelsey Jones, for instance, a 29-year-old former grocery-store manager in Columbus, Ohio, borrowed $1.1 million over the past year to purchase four rentals in the Great Smoky Mountains in Tennessee, according to a June 14 Bloomberg dispatch. How did she do it? By tapping into the mortgage lenders who underwrite based on projected rental income rather than a borrower's current earnings. Bloomberg cited Hometown Equity Mortgage, LLC, which does business as "theLender" and advertises its NONI loans to would-be hosts. (The acronym signifies "non-owner, no income.")

To such striving landlords, the pandemic-cum-recession was nothing less than a boon. For one thing, mortgage forbearance meant that borrowers could postpone payments during the slow months of 2020. For another, the stimulus-funded egress from cities produced its own bonanza. However, post-bonanza, a slowing travel market without large dollops of monetary and fiscal aid could cause financial distress in the leveraged segment of Airbnb's host cohort.

ABNB, which made its public-company debut on Dec. 10, 2020 at a price of $68 per share, achieved a peak price (to date) of $216.84 this past Feb. 11 and stands today at $102.27. Let's assume that the bulls are right and the company will compound its revenues at a double-digit rate for years to come. What would the stock be worth?

"We think it can go to $49," David Trainer, the founder and CEO of the boutique research firm New Constructs, LLC, tells me. To get to this target, he uses a cash-flow model with a 10.4% discount rate and the following bullish assumptions: Net operating profit after tax margins will double to 18% by 2030 from the 2021 level; revenues will grow by 32% this year, 20% in 2023, 21% in 2024 and by 15% annually through 2030.

Even ignoring the cyclicality of the travel industry, then, ABNB could be stuck in growth purgatory for many a moon. The Nasdaq Composite Index was 15 years in overtaking its March 10, 2000 high following the collapse of the dot-com bubble. Price and value matter, too.

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Airbnb at a glance
all figures in USD millions except per share data

	TTM*	2021	2020	2019	2018
revenues	$6,613.8	$5,991.8	$3,378.2	$4,805.2	$3,652.0
operating income	871.1	429.3	-3,590.1	-501.5	18.7
net income	801.4	-352.0	-4,585.7	-674.3	-16.9
earnings per share	1.35	-0.57	-16.12	-2.59	-0.07
shares	635.3	615.9	284.4	260.6	256.3
cash	6,886.6	6,067.4	5,480.6	3,074.3	3,329.3
debt	1,983.6	1,982.5	1,815.6	0	0
assets	17,068.4	13,708.5	10,491.5	8,310.1	6,613.1

* The 12 months ended March 31, 2022.

source: company reports