Antrim Investment Research

June 30th, 2020

Initiation of Coverage

Long: Despegar.com (NYSE:DESP)

Rating: BUY / ACCUMULATE

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Antrim Investment Research

Initiating Coverage of Long Position: Despegar.com, Corp. – NYSE:DESP

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We inaugurate coverage of a long position in the Antrim Portfolio, Despegar.com, Corp (NYSE:DESP), with a BUY rating, and high conviction.

Executive Summary

Since coming public in 2017, Despegar shares have been under near constant pressure due to a variety of exogenous shocks and macroeconomic factors outside of the company's control. Lackluster GDP growth in Latin America has pressured demand, dramatic currency devaluations have destroyed customer purchasing power and hampered translation of Despegar's results into U.S. Dollars. Sharply increased interbank lending rates have restricted profitability, and the coronavirus pandemic has resulted in government-imposed lockdown and the restriction of non-essential travel. For these reasons, DESP has been summarily ignored by the market, and presently offers investors who can tolerate elevated volatility the opportunity to purchase an extremely high ROIC business with local currency bookings growth in excess of 20%, negative working capital, and a fragmented base of local competitors and suppliers, all at a bargain basement valuation.

Market Inefficiency, or "Why is it Cheap?"

- Slow GDP growth has led to reduced demand for travel in Latin American economies.
- Runaway inflation (currency devaluation) in key end markets (Argentina, Brazil) has obscured DESP growth rates and profitability when translated into USD.
- Sharply higher interbank interest rates hamper DESP's ability to factor receivables profitably.
- The Coronavirus pandemic has decimated demand for DESP services in the near term.

Catalysts

- New coronavirus cases in South America and Brazil to peak and start declining.
- A weak U.S. Dollar could flatter f/x comparisons, going forward.
- Integration of Best Day and Viajes Falabella acquisitions will result in cost & revenue synergies.
- Increasing % of captive traffic from DESP's mobile app will reduce customer acquisition spend.
- Accelerating revenue growth.
- Margin expansion.

Base/Bull/Bear Case

- **Base Case Price Target:** $8.42 – 17% upside
- **Bull Case Price Target:** $10.03 – 40% upside
- **Bear Case Downside:** $6.28 – 12% downside

Please consult the body of this coverage initiation report for an elaboration on our investment thesis, as outlined in this summary.

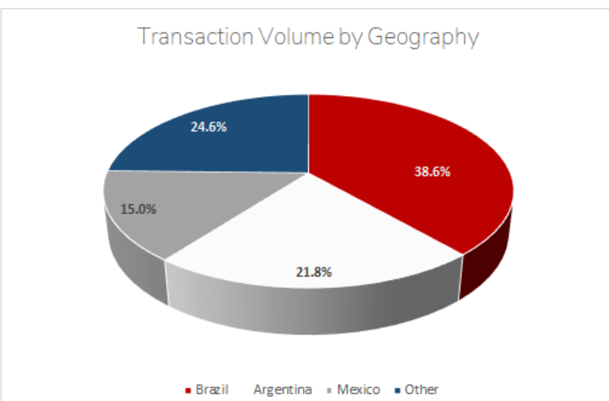
Company Description and History

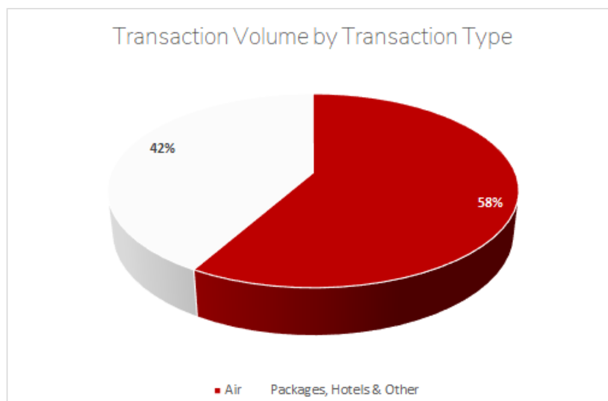
Despegar.com Corporation is the predominant online travel agency ("OTA") in South and Latin America. Through its website and mobile applications, the company offers airline and hotel reservations, as well as reservations for other ancillary travel packages and services. The company operates in two segments, "Air and Packages," and "Hotel and Other Travel Products." The company operates marketplaces where its suppliers can manage the distribution of their products and its customers can compare, plan, and purchase travel and travel related products. The company operates under the Despegar and Decolar brand names.

The company's website launched initially with an inventory of airfares in Argentina before beginning to expand its geographical footprint, finding success in Brazil, Chile, Colombia, Mexico, Uruguay, Venezuela, and the United States. Its success and expansion as the pre-eminent online marketplace for airfares in South and Latin America culminated with Tiger Global's decision to back the firm in 2007. In 2009, Despegar launched their hotel products, and began a second phase of geographical expansion, entering Bolivia, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Nicaragua, Panama, Paraguay, and Puerto Rico. The company launched packages, rental cars, and cruises along with its mobile app in 2012, growing their user base to 2.7M customers. By 2013, the company's mobile app had been downloaded 1M times, and by 2016, over half of Despegar's customers had downloaded the mobile app.

In 2015, Despegar took another step towards becoming the public company we are familiar with today, deepening its strategic partnership with Expedia, at which time Expedia made an equity investment in the company, which they've maintained to this day. In 2017, the company completed a successful IPO on the NYSE, priced at $26/share.

Revenue Breakdown





Despegar's 20-F filing discloses transaction volumes by geography, but only breaks out transactions in 3 geographies, Brazil, Argentina, and Other. The company has disclosed publicly, however, that Mexico makes up roughly 15% of transactions. They have not disclosed a pro-forma breakdown for transaction volumes since the acquisition of Mexican travel agency Best Day, but we expect Mexico transaction volumes to surpass Argentina's soon, at which point the country will likely be disclosed separately.

Negative Working Capital – The Structural Advantage of a Travel Agency

To the extent that a subjective measure like "quality" can be evaluated using Cash Returns on Invested Capital, a successful OTA must be regarded as an enterprise of the highest caliber. That the business is conducted online already implies that little in the way of invested capital is required for a "bricks and mortar" retail infrastructure of stores or facilities. The singular focus on travel ticketing and reservations removes the requirement that any physical inventory need be acquired, warehoused, or distributed. Invested capital, as a result, tends towards intangible assets – customer lists from acquired competitors, brand recognition and app downloads, and the literal goodwill of the marketplace participants, to recast an accounting term in the light of its intended application.

But travel agencies have another built in invested capital advantage, which manifests itself in the payment terms they demand from customers as opposed to those they are granted by their suppliers. In the case of an airfare, Despegar often acts as a pure intermediary, with the airline the merchant of record on the transaction, and Despegar's fees, or "take rate" simply subtracted from the credit card payment made by the customer, which is, in turn, deposited in the Airline's account. To the extent that Despegar is sometimes the merchant of record on an airline transaction, however, the company has up to 30 days to pay the airline, in local currency, their portion of the customer fare. Payments in South America are often made in installments, but Despegar is able to factor these receivables more or less immediately, which creates a mismatch in terms of working capital, whereby Despegar receives cash up front from the customers (or rather, from the banks who factor customer receivables) and is able to hold that cash for up to 30 days before settling a payable to the airline.

With the expansion into Hotel reservations in 2009, Despegar reduced their working capital need even further. Hotels are accustomed to billing a customer for their stay in arrears, at check out, rather than in advance, at the time of booking. Despegar's scale, influence, and credit rating afford it even better terms with hotel suppliers. They "settle up" within 45 days *after* check out. When a hotel is booked on Despegar.com or their mobile app, the customer cash is deposited virtually immediately in Despegar's account, while the hotels are paid only 45 days after the customer stay. Given an average booking window for leisure travel of 3-6 months in advance, it's clear that Despegar is able to operate with negative working capital for as much as 2 to 3 quarters in the case of a hotel booking. Hotels make up 42% of Despegar transaction volume, and generate substantially higher earnings and returns for the company.

In this way, Despegar is able to self-fund growth and branding initiatives with their customer's own cash, as long as the business is growing. To say that Despegar operates an "asset lite" business model would be understating the true nature and benefit of running an online travel agency. At sufficient scale and with growth, it's actually an "asset negative" business model, which substantially reduces the company's need to ever access capital markets or dilute existing shareholders.

Of course, payables must eventually be paid, and in times when bookings collapse, the accounts payable liability on Despegar's balance sheet does loom large. In these instances, the analyst is best inclined to view cash itself as an operating asset, rather than a non-operating one. The current difficulty with travel demand and cross border travel restrictions resulting from the coronavirus pandemic has illustrated this point clearly, and Despegar has received high marks for managing the decline and associated liabilities. (More on this later)

South American Travel: End Market Analysis

South and Central American economies are emerging markets. In aggregate, there are 464M people across South and Central America, and yet, the economies of South America collectively accounted for only $3.5T of gross domestic product in 2019. This compares rather unfavorably to developed economies like the EU ($18.8T in GDP) or the U.S. (21T in GDP), despite a similar population. South American GDP per capita of roughly $8,300 U.S. lags behind China (near $10,000 USD), but dwarfs India ($2,000 USD). Despite that, visitors to South and Central America will recognize a bustling, modern economy. There are excellent tourist destinations and restaurants throughout the continent. Taxis are hailed, and food ordered using mobile apps. There is poverty, and inequality, to be sure. But the overarching headwinds facing South American economies, broadly speaking, are political rather than structural.

Against this backdrop, it is perhaps unsurprising that the South American travel market is structurally under-served, and forecast to grow at well above GDP rates for as far ahead as even the boldest forecasters are willing to venture. A Euromonitor International industry white paper suggests that the South American travel end market is expected to grow 6% (in local currency) over the next five years, while online bookings are forecast to grow at 9%, and mobile bookings are growing 19% annually. Within each of those categories (except perhaps, mobile, where the strong growth is merely representative of the rate at which DESP is increasing), DESP is taking share from local competitors who operate bricks and mortar travel agencies, arranging package travel deals for new international travelers, often on their first cross-border excursion. And Despegar is not the only Latin American company to note that the travel industry on the continent is structurally underserved.

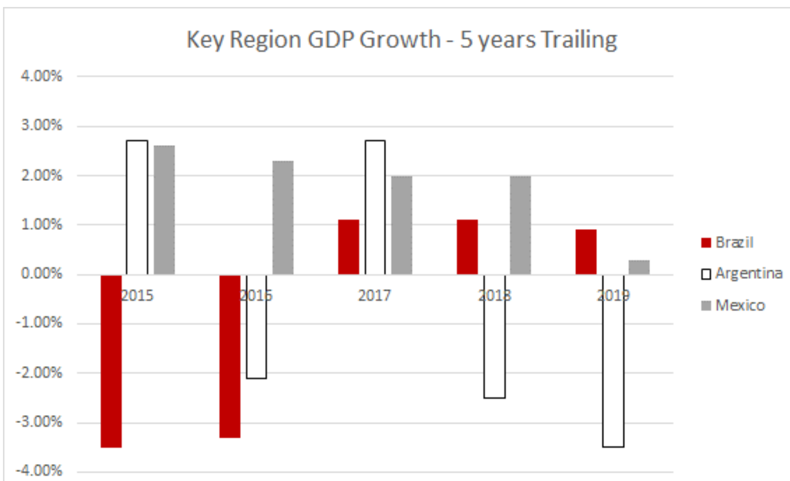
Copa Airlines discussed a relative paucity of available seat miles for the aspiring South American traveler during their 2019 investor day in Panama City. 80% of the markets that Copa airlines serves have fewer than 20 PPDEWs, or "passengers per day, each way." Copa demonstrates how the low passenger volumes necessitate a "hub-and-spoke" approach to building out their airline's destination network, but they inadvertently hint at another reason to expect above-GDP growth from South American travel over the coming years. As demand improves in existing markets, enabling the expansion of viable airline networks to new markets, the new destinations will meet travel demand that was previously unserved, improving profitability and travel volumes across the whole of the network. In this way, the growth of leisure travel in an emerging and structurally underserved economy generates somewhat of a "flywheel effect," whereby emerging demand begets increasing supply, which begets increased demand, ad… well, not infinitum. U.S. investors would have watched this effect play out over a period of decades, but they were only able to invest in the airlines and hotel chains or resort properties themselves. The idea of the travel agency as an investable asset, and the online travel agency at that, came only later.

In Despegar's case, shareholders benefit both from the emerging nature of the South American leisure travel industry, and the quality and scant capital requirement of the online travel agency business model. As Despegar collectively wields the attention of ever-increasing numbers of users on their site and their app, their importance as a traffic source for local and regional suppliers only grows more entrenched. As they continue to attract more diverse suppliers and better economic terms, they can offer increasingly attractive fares to loyal customers. The company finds itself a key participant in the early innings of a volatile, but well-heeled secular growth trend.

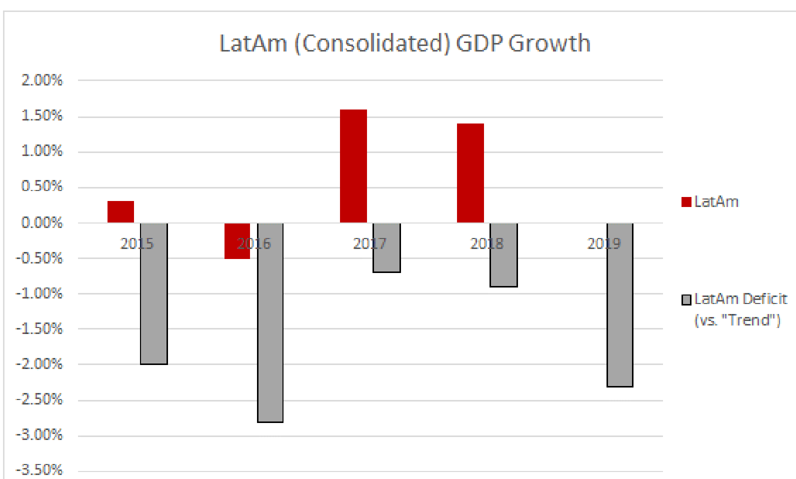
Despegar in Recent Memory: Depression, Devaluation, and Disease

As the markets roil in response to the coronavirus pandemic and the resulting lockdowns and government-imposed travel restrictions, it is unsurprising, perhaps, that DESP shares have suffered during 2020. At the time of the company's Q1 call, they disclosed that the second half of March had seen a 95% year on year decline in gross booking activity on the Despegar platform. But keen observers will note that Despegar's troubles did not begin with the global export of the novel coronavirus in early 2020. Rather than company has been suffering from nearly the moment of it's IPO on NYSE in September of 2017. The reasons DESP shares have performed so poorly are threefold. First, South American economies have struggled, in aggregate, to generate even trendline GDP growth during the second half of the 2010s. Second, the Brazilian Real and Argentinian Peso have devalued dramatically vs. the U.S. Dollar, in which DESP reports results. And lastly, sky high central bank interest rates meant to combat runaway inflation have hampered DESP's ability to economically factor receivables in a region known for the prevalence of installment payments. The coronavirus itself is only the latest in a long line of calamities that have obscured Despegar's true earnings power and depressed its shares to today's bargain prices.

A casual glance at GDP growth in Despegar's key end markets paints a dour picture of Latin America's consolidated macro-economic positioning:



And in point of fact, consolidated GDP growth numbers have remained consistently below trend:



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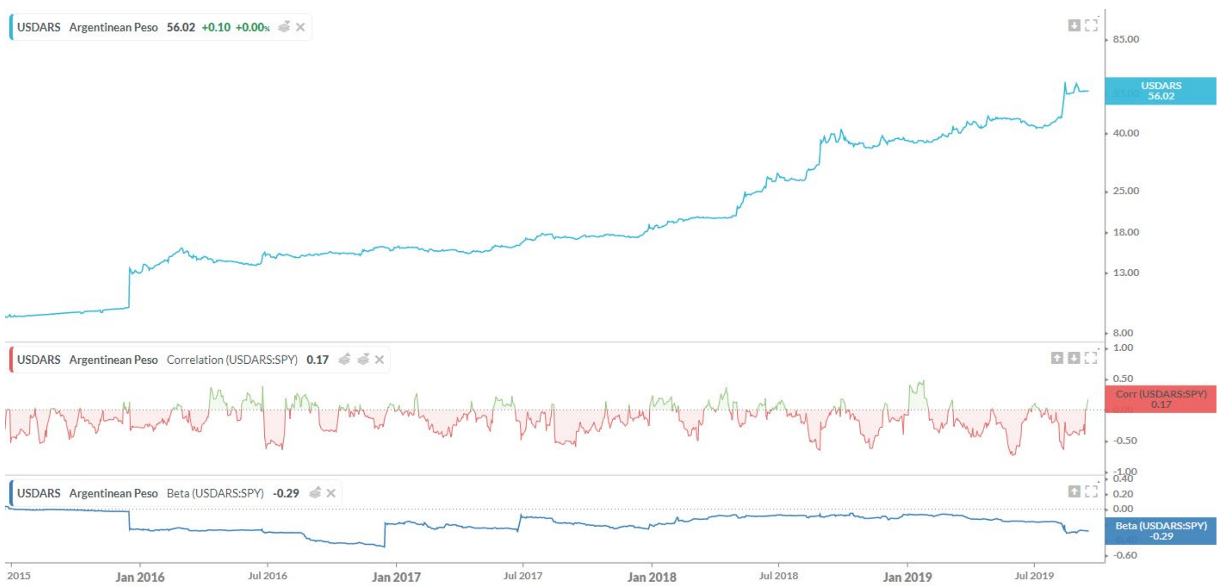
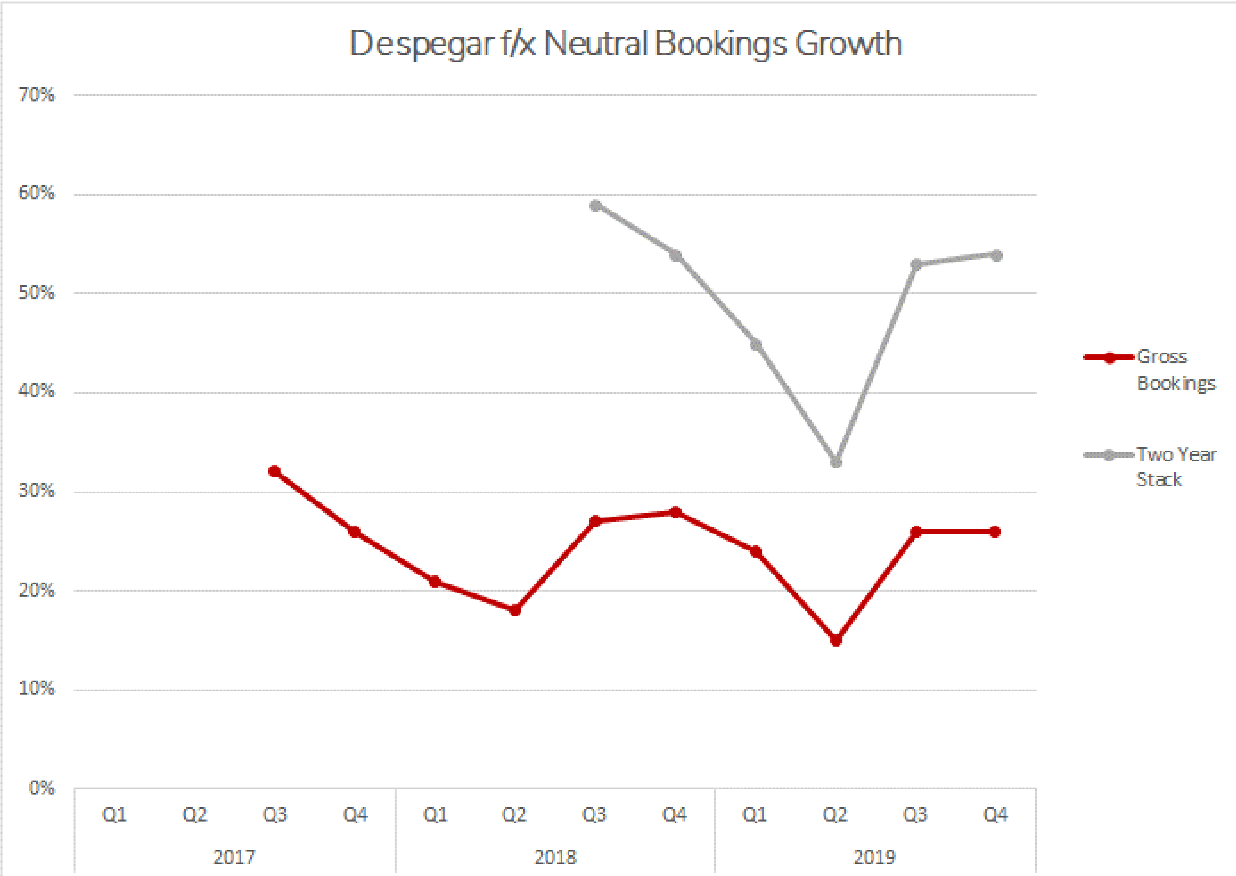
As a result, key DESP transactional currencies have depreciated vs. the dollar. In 2015, you could buy a U.S. dollar for 3 Brazilian Real. Today that exchange would cost 5.31 real:

The Argentine Peso has fared even worse. Where 9 Pesos could fetch 1 U.S. dollar in 2015, today 56 are required:



These devaluations represent real, tangible destruction of international purchasing power for Despegar customers in their transactional currency. It offers Despegar no flattery as they translate constant currency bookings and revenue growth into dollars for U.S. Investors to satisfy NYSE listing requirements, but it also actively destroys demand for international travel as local consumers watch the purchasing power of their paychecks rapidly deteriorate. Despite this, Despegar has maintained amazingly high rates of year on year gross bookings growth in constant (local) currency.

Constant Currency Gross Bookings Growth History



[1]See footnote re: Q2'18 estimate

It is undeniable that the devaluation of the Brazilian real and Argentine peso have destroyed value for DESP shareholders based in the U.S., but it is simultaneously undeniable that results reported in U.S. Dollars do not reflect the underlying demand for Despegar's services, or their efforts to help expand the demand for leisure travel in Latin America. The fact that the company has seen scant deceleration in local currency bookings, despite a meaningful destruction in their customer's international buying power, speaks volumes about the latent demand for international leisure travel amongst the Latin American consumer.

Despegar has a Fragmented Supplier Base – What does it mean for Operating Margin %?

The online travel agency business model lends itself to the "winner take most" paradigm familiar to investors who have followed e-Commerce businesses who use their platform to create network effects that act as natural barriers to competitive entry. In the OTA space, the behemoths are BKNG (Booking Holdings, which consists primarily of Priceline.com and Booking.com), and EXPE (Expedia), who have "taken most" of the lucrative United States and European end markets. But Wall Street has preferred BKNG to EXPE for much of the history of the two public companies, primarily as a result of BKNG's superior operating margin performance.

[1] Pre Q2'18, bookings are in USD growth terms, Q2'18 is an Antrim estimate of f/x neutral growth, and in Q3'18, as well as all datapoints thereafter, the company disclosed local currency bookings growth

Historically, the companies had operated different business models. Priceline (formerly ticker: PCLN, now BKNG) was an "agency" who booked only their "take rate" as revenue, at high incremental margins, while EXPE was a wholesale merchant of unsold hotel rooms, who booked whole rentals as revenue, and generated profit on the spread between their fare and the cost of their "inventory." Today, the business models are largely similar. BKNG holdings generated revenue of $15B on $70B of agency bookings, and $26B of merchant bookings ($96B in total). EXPE generated revenue of $12B on $107B of gross bookings, despite nearly the opposite mix of business. BKNG generated operating margins of 36%, while EXPE had operating margins of only 8%.

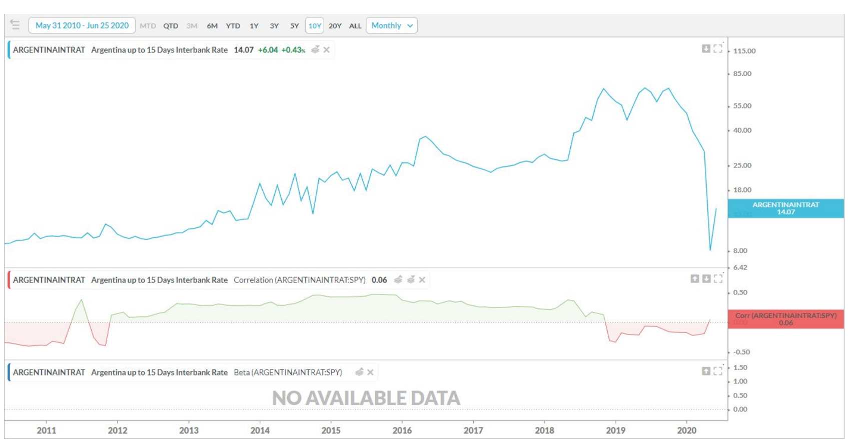
This is due in large part to supplier mix. EXPE, who has an extraordinary market share in the U.S., and a higher mix of airfare vs. hotel packages, is beholden to 10 large hotel chains that represent over 50% of the total hotel rooms in the country. The top 4 airlines represent 56% of air travel in the U.S. In Europe, only 20-25% of hotel capacity is represented by an integrated chain (though an additional cohort represent themselves as something of a consortium for negotiating purposes). In LatAm, where Despegar has a leading market share and brand awareness position, the top 10 hotel chains represent only 7% of the market. The top 4 airlines represent only 31% of gross bookings. Lackluster GDP growth and currency volatility have continued to keep the chains away. 5 years ago, the top 10 hotels represented 15% of LatAm capacity.

It seems rather likely, therefore, that DESP operating margins ought to tend towards those of BKNG over time, rather than those of EXPE. The structural factors driving BKNG's superior take rates and operating margins would seem to benefit a LatAm OTA as well.

Punitive Interest Rates – Negatively Impacting DESP Profitability

One aspect of LatAm that will be less familiar to U.S. based investors is the prevalence of installment type payments for large purchases. Data from EBANX (a cross border payment processing provider in LatAm) suggests that installment plans account for up to 60% of e-Commerce transactions. 77% of Argentinian households are paying cuotas. That may be high, even for LatAm, but it's representative of the end market.

The way installments work for Despegar, to the extent that Despegar is the merchant of record on a transaction, is that DESP works with local banks to factor receivables, selling their installment receivables for an up-front cash inflow that represents the Net Present Value of the installment plan at the prevailing interbank interest rate. As a result, higher rates negatively impact DESP profitability in the near term, as consumer demand is price sensitive, and fares tend to be somewhat rigid despite macroeconomic volatility. Unfortunately, the Argentine interbank rate has skyrocketed over the past decade as runaway inflation has taken hold, reaching nearly 70% in 2019:



Of course, the current rate of 14% is more consistent with the region and conducive to factoring receivables. But gross bookings are missing in action.

Coronavirus, Lockdown, and Cash Burn – Despegar has enough runway to take off

A 95% year on year reduction in gross bookings is not to be taken lightly. Indeed, Despegar analysts are afforded a unique opportunity to model the business's income statement, "from the ground up," with a starting point of 0 revenue and only "essential" opex. As travel volumes return, Despegar will likely be forced to disclose enough information to glean average ticket, unit volumes, and for analysts to determine what truly represents a bare bone, "breakeven" run rate. After the initial recovery, a step function increase in operating expense will occur as necessary but non-essential fixed operating costs return. And finally, an ongoing, "steady state" free cash flow will be reached. At that point, Despegar (and shareholders) will be tasked with understanding the degree to which the company is investing to grow user base, maintain brand awareness, and the ROIC on investments in marketing, together with the total value over the lifetime of each incremental customer, will determine the multiple investors place on DESP shares. But for any of this to come to pass, the company will need to survive the pandemic with enough capital to restart the business's normal operations. To wit:

Despegar reported their Q1 results on May 4th and announced that during the quarter, the company had cancelled a significant portion ($134.6M) of their outstanding tourist payables. The company had $52.9M remaining in net payables on the balance sheet but felt that those would be covered by the company's ongoing (minimal) cash flows from operations, as well as cash on the balance sheet. The company ended the quarter with $226M of cash on hand. ($173.1 net of the outstanding payables balance), in order to remain afloat while burning cash during quarters with little or no travel demand.

To assess run rate cash burn – I've turned to company presentations regarding cost structure optimization and efficiencies that Despegar was trying to generate already in response to lackluster economic growth in LatAm. By the end of 2019, I estimate that the company had reduced run rate quarterly opex to $55M per quarter. In response to the crisis, the company instituted temporary salary reductions of 50% for upper management, 25% for middle management, and eliminated inflation adjustments to salaries company wide, along with first half bonuses. As a result of these actions, Despegar estimates that Q2 opex will be even lower, at $34M. By Q3, they believe run rate cash burn will be reduced to $28M per quarter. Simple arithmetic arrives at the conclusion: Despegar can survive with no revenue, no further cost reduction, and no capital raise until the end of Q3, 2021. Of course, employee retention could theoretically be difficult during this time. It is Antrim's position, as of now, that severe economic weakness and pandemic/lockdown reduced unemployment will actually bolster employee retention efforts, regardless of cost savings initiatives. This is a key aspect of the story worth monitoring on an ongoing basis.

Antrim's work and estimates indicate that, in the current environment (which likely represents something closer to trough profitability than "normal" profitability), DESP has an average ticket of roughly $36 USD, with approximately $20 in gross profit per transaction. At $28M in quarterly run rate costs, DESP's breakeven requirement is roughly 1.4M transactions. For comparison's sake, in Q1 of 2019 Despegar's platform saw 2.64M transactions. In Q1 of 2020, 2.09M. Incidentally, seasonality is somewhat dependent on Despegar's geographical mix of business, and the company is well diversified. November – March is peak tourist season in Patagonia (Argentina), while June – August is peak season for visitors to Peru. Central America (including Mexico) tends to operate on a more U.S. centric schedule, where calendar quarters 2 and 3 are "peak" for leisure travelers.

Antrim is currently still modeling for a return to 60% of "normal" leisure travel volumes by Q1 of 2021, and therefore, we anticipate no problem for Despegar returning to cash breakeven before running out of capital. We estimate at this time that the company will require little or no capital to "restart" operations, and that Despegar will not require outside financing at any point over the next 6 quarters. (With prudent conservatism, Despegar established a $40M revolving line of credit on June 23rd to further bolster liquidity should the pandemic impact be prolonged. To my knowledge, this line has not been drawn on to date.) This should give investors ample time to assess Despegar's growth rates, margins, and cash flows as the conversation shifts back to: "normalized earnings power," and it is our contention that DESP shares will re-rate higher.

Capital Allocation – Acquisitions bolster organic growth

It will be some time before a shareholder criticizes DESP capital allocation in light of the current pandemic and cash burn resulting from total lockdown and government-imposed leisure travel restrictions. But as I am a betting man, I'd be willing to wager the company will be asked before Q3 2021 what they plan to do with excess cash on their balance sheet.

Thus far, the answer has been the same: opportunistically acquire those regional competitors who offer additional capabilities or end markets to Despegar, in order to build out their offering of packages, excursions, geographic destinations, and event ticketing. These acquisitions supplement organic growth and bolster network effects that create barriers to competitive entry and widen the gulf between Decolar.com and local travel agencies, to say nothing of Booking Holdings or Expedia's regional offering.

Two rather larger acquisitions have been consummated in the past 12 months: Viajes Falabella, which closed on 7/31/2019, and Best Day Travel Group, which has yet to close. Both acquisitions offer Despegar geographical diversity, and bolster vacation excursion package offerings on the website. Viajes Falabella generates nearly half of their business in Chile, with a quarter in Colombia, and the remainder in Argentina, which is already home to Despegar. The company is a large mall-based retailer in South America, which does bring some bricks and mortar infrastructure to Despegar, but the capital requirement remains minimal. Investors will recognize Viajes Falabella storefronts as little more than "kiosks," where travelers can book local excursions and plan daytrips. Revenue synergies would be evident if leisure travel had not been banned entirely, as Viajes Falabella's offerings have already been fully integrated into Despegar's online platform. I fail to see how access to Decolar.com, its customer base and traffic could fail to grow Viajes Falabella's revenue at an attractive margin, all the while shifting Despegar's revenue mix to an ever increasing % of packages as opposed to simple Airfares. Best Day Travel Group operates a substantially identical business in Mexico. Importantly, this acquisition has been restructured in light of current events, so that Despegar will not have to make a cash outlay at closing, and in fact owes Best Day shareholders nothing until 36 months after the closing date.

Suffice it to say that acquisition activity will remain on hold until demand returns to normal.

The App Advantage. Captive Traffic Reduces DESP Customer Acquisition Cost ("CAC")

In its Q3 2019 report, EXPE disappointed investors (slightly) with top line results, and dramatically disappointed regarding operating margins, sending the stock nearly 25% lower in a single day. The culprit, according to management on the conference call, was a "change in Alphabet (GOOG) algorithms for paid search." At this point, most, or all, investors will be familiar with Google's bifurcated search platform, wherein users are presented with two different types of links. Paid, or sponsored links, and unpaid, organic links. For a company like Expedia, managing customer acquisition costs has historically been an exercise in Search Engine Optimization ("SEO") which ensured that Expedia results remained relevant to users, and were prominently displayed at the top of the heap of "organic" links when would-be-travelers put common search terms into Google. Of course, paid links are an enormous part of the OTA marketing arsenal, as well.

But in 2019, Google rolled out enhanced travel features to wring an extra dollar out of, well, Expedia. When searching for airfares and hotel accommodations, Google users are no longer immediately redirected to Expedia (or Decolar) via paid and unpaid organic links, but are actually presented with travel options and fares, scraped from the sites like Expedia themselves. When a user interacts with the "enhanced" travel configurations on the results page, they will ultimately be redirected to EXPE, but this "click" is considered "paid search" and not "organic search results." Ultimately the pricing breakdown between paid/sponsored search, organic search, and enhanced search features is a bit more complicated, but the upshot for Expedia was that it was an order of magnitude more difficult for the company to generate low cost traffic, reliant as they are on Google traffic origination.

Despegar, which ostensibly has a similar business model, was relatively unaffected. The reason for this positive divergence was not well understood for investors, despite its simplicity. The company generates a substantial portion of its traffic through its mobile app, bypassing search entirely. In 2019, 37% of traffic on Decolar was sourced via the Mobile app platform, which resulted in a mix of paid/non-paid traffic acquisition of 31% and 69%, respectively. Mobile app penetration has continued to grow apace, reaching 37% of total traffic in 2019, up from only 27%, just two years prior. Antrim intends to track this metric closely, because we believe it is underappreciated by investors.

While most were able to discern that DESP was not affected by Google's decision to add enhanced travel features in the same way as EXPE, we perceive that few have attempted to contemplate or quantify the impact of that revelation on DESP valuation. It is Antrim's position, that to the extent Despegar is able to convert new customers into app downloads and increase the proportion of "captive" traffic in their business mix, that customer acquisition costs should ultimately be capitalized. The company operates in a region of the world where many of their customers are making their first trips abroad, so their financials currently look exactly like those of Expedia. They book a fare, less the cost of the customer acquisition and the transaction processing. But return customers, to the extent that they return through Despegar's app, because they had downloaded it during their first interaction with the company, are more profitable. In this way, Despegar's customer acquisition costs might reasonably be capitalized and excluded from "steady state" operating earnings. So too could goodwill consisting of the customer lists from acquired competitors be considered a tangible asset. Ultimately, these investments will manifest themselves in increasing margins and operating leverage in future fiscal years, and lend support to Antrim's belief that DESP operating margins will trend towards those of BKNG (36%), and away from those of EXPE (8%). It is telling, in this regard, that EXPE chose to partner with DESP rather than compete with them.

Index and ETF Inclusion

One contributing factor to DESP underperformance is a lack of inclusion in passive investment vehicles. Of the "big five" ETF sponsors (BlackRock, Vanguard, State Street, Invesco, and Deutsche Bank, only Blackrock has any stake in DESP, a $5M position. DESP is not a constituent of the MSCI Emerging Markets Index and will not be found amongst the constituents of the EEM. The most likely ETF to provide investors with passive exposure to DESP is the EMQQ, a niche "Emerging Market Internet and eCommerce" subsector ETF managed by Exchange Traded Concepts, LLC, which has a 0.08% position in DESP.

The EMQQ ETF has had steady, albeit slow, in-flows over the course of its life. It would appear, based on their semi-annual filing at the end of February and the current NAV of the fund as compared to the increase in the market price of its shares, that inflows into the ETF have accelerated in the last 3 months. This acceleration of in flows would be consistent with increases seen, broadly speaking, in small brokerage accounts, odd lot trading, and other popular sector ETFs like JETS.

Large Shareholder Overhang

To the extent that index inclusion is determined on a float weighted basis, and to the extent that many investors view the existence of large private equity shareholders as an overhang for a stock, it does DESP no favors that Tiger Global owns over 13% of the outstanding shares, and Expedia owns another 14%. Tiger Global has already distributed one slug of shares from its Private Investment Partnerships (PIP Series) to its own shareholders and may seek to exit the remaining portion of their DESP shareholding at some point in the future. It is our contention that Expedia's share ownership should be viewed as permanent "insider" ownership, and that Expedia's interest in Despegar remains strategic in nature.

Despegar has Strategic Value to Expedia (which owns 14% of the company)

While Booking.com has tried to compete directly in Latin America and ranks 4th in unaided brand awareness studies done by Despegar Market Insights Brand Tracking, Expedia ranks only 11th, with a single digit percentage of respondents able to identify the Expedia brand. Regional quirks like installment payments are intuitive and integrated on Decolar.com, they are foreign to international competitors, or unavailable. As a result, Expedia chose to partner with Despegar, making an equity investment that amounts to 14% ownership of the company in 2015, and partnering with Expedia on cross border bookings between LatAm and the U.S.

The agreement with Expedia does have a $125M termination fee, payable by Decolar to Expedia, which would only be triggered if Despegar chose to terminate the agreement, or if Despegar failed to deliver certain minimum bookings volumes to Expedia, causing Expedia to terminate the agreement. Some analysts have interpreted this "termination fee" as a contingent liability based on travel volumes. It is my best understanding that Expedia is not interested in terminating the agreement, and even if they were, bookings volumes below minimum as a result of the coronavirus pandemic and government imposed international travel restrictions would be force majeure, rather than a failure to deliver on the part of DESP.

Valuation

We prefer to value all companies under our coverage using an unlevered free cash flow yield on total adjusted enterprise value. To demonstrate the effect of capital structure on equity returns, we also take into consideration the fully levered free cash flow yield on equity:

DESP unlevered 2019 FCF yield on Total Adjusted EV: 6.1%
DESP fully levered 2019 FCF yield on Equity Market Cap: 2.7%

For those who prefer the valuation heuristic of traditional comparable multiples, Despegar trades at 0.9x EV/Trailing Sales and is forecast to generate negative EPS as a result of the coronavirus. Still, these multiples compare favorably to other listed OTAs:

OTAs	Market Cap ($B)	Forward P/E	EV/Sales
Booking.com	65.9	140.4x	4.7x
Expedia	11.5	204.8x	1.4x
Ctrip	15.7	167.5x	4.0x
average	31.0	170.9x	3.4x
Despegar	0.5	n/m	0.9x

Despegar's severe discount relative to peers reflects macroeconomic uncertainty in its end markets. But it also reflects the market's failure to adequately discount DESP's prospects for future growth, coupled with characteristics that augur for operating margins closer to those of BKNG than those of EXPE. The fact that 30 or more sell side analysts average slightly positive consensus EPS for BKNG, EXPE, and CTRP, while the few analysts actually covering DESP have negative EPS estimates for the duration of the pandemic reflects the stale nature of consensus #'s in the "well" covered names, not a structural deficiency on the part of DESP.

Antrim has looked to DESP's fiscal 2017 as a touchstone for more "normalized" profitability. While that year represents a near term peak profitability for DESP, it remains fact that their largest market, Brazil, was in the throes of economic depression at that time, and that DESP has continued to grow, in local currency, at an annual CAGR of 20%+ since then. In 2017, DESP generated EPS of $0.69 per today's shares, and the company trades at only 10.4x that number. In contrast, BKNG and EXPE each trade at 32x 2017 EPS.

Justifications for Market Inefficiency

- **Slow, or negative GDP growth has led to reduced demand for travel in Latin American economies.** After 5 years of sub-trend GDP growth, it seems hard to understand how the last 20 years saw Latin American aggregate GDP growing at an annual CAGR of 2.3%. The simple, and obvious, answer is that GDP growth in the region has been, at times, much higher. Based on demographics alone, Antrim is equally as bullish over the next decade as we are cautious over the next year.
- **Runaway inflation (currency devaluation) in key end markets (Argentina, Brazil) has obscured DESP growth rates and profitability when translated into USD.** It is important to recognize that Despegar transacts all of its business in local currency. The transactional impact of severe currency devaluation is the destruction of its customer's purchasing power in terms of foreign dollars. The impact observed by U.S. based investors focused exclusively on DESP the NYSE listing is primarily translational.
- **Sharply higher interbank interest rates have hampered DESP's ability to factor receivables and reduced profitability.** Partly as a result of the pandemic, the Argentinian interbank rate has already normalized. It is the position of Antrim that investors might reasonably forecast a period of U.S. dollar weakness resulting from unprecedented and unabated money-printing and fiscal stimulus, that will significantly reduce pressure on South and Latin American economies, which tend to finance government expenditure through borrowings denominated in U.S. Dollars.
- **The Coronavirus pandemic and government mandated restriction on international travel has decimated demand for DESP services in the near term.** We believe that DESP has the capital to survive, while many of their local competitors do not. Provided we see some resolution to the crisis or at least a deceleration of the rate of transmission of new cases in South America, it is our contention that DESP will emerge from lockdown in the strongest competitive position the company has ever enjoyed.

Catalysts & Antrim Catalyst Map

- **New coronavirus cases in South America (AND BRAZIL) need to peak and start declining.** Investors are monitoring these datapoints in real time.
- **Interbank interest rates in Argentina have already normalized.**
- **A weak U.S. Dollar could flatter f/x comparisons, going forward.**
- **Integration of Best Day and Viajes Falabella to result in synergies.**
- **Accelerating revenue growth.**
- **Margin Expansion.** Once more for those in the back, we believe that DESP has the structure in place to aspire to margins approximating those of Booking Holdings (36%), over time.

<table>
<tr><td>Fiscal Year</td><td colspan="4">2020</td><td colspan="4">2021</td><td colspan="3">2022</td><td colspan="4" rowspan="2">& Beyond</td></tr>
<tr><td>Fiscal Quarter</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td><td>Q3</td></tr>
<tr><td>Catalyst</td><td></td><td colspan="2">Normalization of Argentina Interbank lending Rate, Closing date: Best Day Acquisition</td><td colspan="2">New Coronavirus cases in decline across South and Latin America</td><td colspan="5">U.S. Dollar Weakness to flatter f/x compares</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Risk Factor</td><td colspan="2">Onset of Coronavirus Pandemic and Travel Restrictions</td><td></td><td colspan="2">Ongoing Travel Restrictions During Peak of LatAm Travel Season</td><td></td><td colspan="2">Step Function Increase in Opex as Incentive Comp is "Added Back" to Model</td><td></td><td></td><td></td><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td>Unspecified Time Frames</td><td colspan="15">Unspecified</td></tr>
<tr><td>Catalyst</td><td colspan="4">Ongoing Secular Expansion of LatAm Leisure Travel Market</td><td colspan="4">Eventual Resolution of Tiger Global Ownership Stake</td><td colspan="3"></td><td colspan="4">Ongoing Secular Expansion of LatAm Leisure Travel Market</td></tr>
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For investors with event driven strategies, or those seeking to use options to take advantage of catalysts on the Antrim Catalyst map, the following dates are relevant:

- **August 8th, 2020 –** Expected date of the company's Q2 report during Fiscal year 2020.
- **November 7th, 2020 –** Expected date of the company's Q3 report during Fiscal year 2020.

While we do not anticipate a meaningful improvement in results during Q2 or Q3, it is currently Antrim's contention that travel restrictions will ease by the time Despegar enters its "peak" seasonal period (Q4'20 and Q1'21).

Antrim Annual Estimates (in thousands of U.S. Dollars, except EPS)

Antrim's DESP estimates are predicated on a few simple assumptions. (1) South American travel volumes will return to breakeven by the peak South American travel season (Q4'20 and Q1'21). (2) Travel volumes will return to 2019 levels as we move throughout 2021, with operating margin expansion demonstrating the benefits of cost cutting actions DESP has taken throughout the latter portion of 2019 and first half of 2020. (3) In Q3 and Q4 of 2020, we will witness a "step function" increase in operating expenses as DESP adds incentive compensation and inflation-based salary adjustment back to the operating model. (4) By 2022, reported growth rates will be equivalent to local currency growth rates, and DESP will continue to grow in local currencies by 20%.

	FY2020	FY2021	FY2022
Revenue	$ 202,000	$ 374,400	$ 449,280
EBITDA	($ 30,000)	$ 50,400	$ 63,840
Earnings per Share (fully taxed)	**($ 0.59)**	**$ 0.42**	**$ 0.57**

Antrim Estimates (Quarterly Detail – forward 12 months)

	20Q2	20Q3	20Q4	21Q1
Revenue	$ 26,950	$ 26,950	$ 72,000	$ 93,600
EBITDA	($ 16,280)	($ 10,280)	$ 14,750	$ 27,000
Earnings per Share (fully taxed)	**($ 0.27)**	**($ 0.19)**	**$ 0.13**	**$ 0.26**

Fair Market Valuation: A Base, Bull, and Bear Case

It is our habit to exercise a valuation discipline which contemplates the discounted present value of future cash flows we expect the firm to generate. We use demanding discount rates, which reflect our desire to underwrite each of our recommendations to our superior absolute return expectation, and we are careful to adjust enterprise values for hidden leverage and assets. In an environment where the S&P 500 has a cyclically adjusted P/E near 30x and the 10-year treasury approaches 0.65%, these targets should appear conservative:

Our base case and target price is generated using Antrim estimates and a 15% discount rate:

DESP	Despegar.com	Year	1	2	3	4 - 10	11
Stock Price	$ 7.18	**Calendar Year**	2020	2021	2022	Growth	Terminal
Shares Outstanding	69.65	**NOPAT**	$ (41,000)	$ 38,400	$ 51,840	$ 540,996	$ 909,193
Market Capitalization	$ 500,087	**Discount Factor**	1.15	1.32	1.52	2.70	4.65
Employee Stock Options	$3,000	**NPV**	$ (35,652)	$ 29,036	$ 34,086	$ 200,523	$ 195,425
Total Debt	$ 55,649	Emergent Growth	10%				
Operating Lease Obligations	$ -	Terminal Growth	3.5%				
Non Operating Cash Balance	$ 221,657	Discount Rate	15.00%				
Net Operating Loss Assets	$ -	**Fair Value**	$ 423,417		**Target Price**		$ 8.42
Total Enterprise Value	$ 337,079	**Fair Market Cap**	$ 586,425		**Upside**		17%

- *This equates to 20.1x our estimate of 2021 EPS, and an EV/EBITDA multiple of 8.4x on Antrim's 2021 EBITDA estimate.*

In our bullish, unbridled optimism scenario, we imagine DESP being valued using a discount rate of 12.5%:

DESP	Despegar.com	Year	1	2	3	4 - 10	11
Stock Price	$ 7.18	**Calendar Year**	2020	2021	2022	Growth	Terminal
Shares Outstanding	69.65	**NOPAT**	$ (41,000)	$ 38,400	$ 51,840	$ 585,776	$ 1,317,920
Market Capitalization	$ 500,087	**Discount Factor**	1.13	1.27	1.42	2.64	4.65
Employee Stock Options	$3,000	**NPV**	$ (36,444)	$ 30,341	$ 36,409	$ 221,766	$ 283,278
Total Debt	$ 55,649	Emergent Growth	12%				
Operating Lease Obligations	$ -	Terminal Growth	3.5%				
Non Operating Cash Balance	$ 221,657	Discount Rate	12.50%				
Net Operating Loss Assets	$ -	**Fair Value**	$ 535,349		**Target Price**		$ 10.03
Total Enterprise Value	$ 337,079	**Fair Market Cap**	$ 698,357		**Upside**		40%

- *This equates to 23.9x our estimate of 2021 EPS, and an EV/EBITDA multiple of 10.6x on Antrim's 2021 EBITDA estimate.*

Our bear case imagines DESP shares are discounted by a pessimistic market at a 18% rate:

DESP	Despegar.com	Year	1	2	3	4 - 10	11
Stock Price	$ 7.18	**Calendar Year**	2020	2021	2022	Growth	Terminal
Shares Outstanding	69.65	**NOPAT (ex-Rent)**	$ (41,000)	$ 38,400	$ 51,840	$ 461,245	$ 479,499
Market Capitalization	$ 500,087	**Discount Factor**	1.18	1.39	1.64	3.13	4.65
Employee Stock Options	$3,000	**NPV**	$ (34,746)	$ 27,578	$ 31,551	$ 147,148	$ 103,065
Total Debt	$ 55,649	Emergent Growth	6%				
Operating Lease Obligations	$ -	Terminal Growth	1.5%				
Non Operating Cash Balance	$ 221,657	Discount Rate	18.00%				
Net Operating Loss Assets	$ -	**Fair Value**	$ 274,597		**Target Price**		$ 6.28
Total Enterprise Value	$ 337,079	**Fair Market Cap**	$ 437,605		**Downside**		-12%

- *This equates to 15x our estimate of 2021 EPS, and an EV/EBITDA multiple of 5.4x on Antrim's 2021 EBITDA estimate.*

Relevant Risks for DESP Investors

- **New Coronavirus cases are still rising across South America.** The situation in Brazil is a particular cause for concern. While Antrim is largely of the belief that the market is underestimating the new economic reality in the wake of the (ongoing) coronavirus pandemic, we also believe that U.S. based investors may be over-optimistically assuming that the economic impact of the crisis in South America is unlike the impact it's having in the U.S. We are not so certain that the divergence will ultimately be as pronounced as the market seems to believe.
- **The U.S. Dollar continues to be viewed as a "safe haven" currency, and dollar strength in the near term may provide a headwind to DESP reported results.** We have repeatedly forecast a period of weakness for the U.S. Dollar relative to international currencies. It would be foolish to ignore the fact that for now, the USD remains a strong, safe haven currency, and the present trend is actually higher, not lower.
- **The U.S. Recession is likely to cause severe economic distress in the emerging markets and could depress demand for leisure travel in Despegar's key end markets for some time.** The pandemic and government-imposed travel restrictions will ultimately end. The recession that remains in its wake must still be felt, however. At this point, it is not possible to quantify the lasting impact that the pandemic will have on LatAm GDP growth, and in turn, the LatAm travel market.
- **Booking Holdings does continue to compete with DESP in South and Latin America.** It is our contention that the utter devastation of local, bricks and mortar travel agencies will produce ample runway for both DESP and BKNG to grow their business in the region. In a winner-take-most environment, a rising tide need not raise all boats. But in our estimation, DESP and BKNG are neck-and-neck, while DESP is priced like a long-shot.
- **Any risks to Despegar's relationship with Expedia must needs be monitored closely.** At present we do not believe that this relationship is a material source of risk for Despegar, but should any fractious disagreement emerge, it would be worth monitoring.

Disclosures

The views expressed in this report represent the views of its author, Eric S. Jensen, Jr. CFA, an investment adviser representative of Antrim Investment Research, LLC, a registered investment advisory in the state of Virginia. Antrim does not conduct financial planning services and cannot assess the suitability of this recommendation for inclusion in any particular portfolio or investment strategy.

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