

Global Innovation

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James Dowey

Co-Head of
Global Innovation



Storm Uru

Co-Head of
Global Innovation



Clare Pleydell-Bouverie

Fund Manager



James O'Connor

Fund Manager

Airbnb: booking beds and profits

Innovation cash kings of the next decade - *In this series we look at the standout companies that are 'pivoting to profit' and are at an inflection point of converting customer-driven innovation into shareholder value. This week we take a closer look at Airbnb.*

'The hotel company without any hotels', Airbnb is often cited as emblematic of technology-led, capital-light businesses disrupting the old guard. Over the 14 years since it was founded, it has also often been used as an example of how such businesses can lack profits for all their innovation.

Things change. On the eve of Covid, Airbnb generated around \$5 billion of annual revenue and was barely breaking even. Out of necessity due to the devastating impact of lockdowns on the business in 2020 and 2021, effectively all-but outlawing the business temporarily, Airbnb dramatically cut costs in order to keep the lights on, including halting all marketing expenses. Many of these cuts were kept as the business rebounded strongly on re-opening, unleashing a much meaner and leaner company. Today, Airbnb generates around \$9 billion of annual revenue and around \$4 billion of free cash flow, a phenomenal 40%+ free cash flow margin. This is what capital-light innovation looks like at scale, and it is a thing of beauty.

What are the fundamental drivers of these outstanding economics? The first is value creation: Airbnb has simply made a market for ordinary people to generate a cash return on what is likely by far the biggest component of their capital stock, and otherwise underutilised and perhaps even burdensome to them. It was far from the first company to try – listing websites like VRBO were founded in the 1990s and, after all, bed and breakfast is not exactly new! – but it has been the first company to substantially solve the challenges of market liquidity and trust to make it a much more mainstream option for both home owners and guests.

Demand continues to grow healthily and Airbnb continues to take share from traditional hotels. With a current stock of over 7 million listings, it saw room nights growth of 11% year-on-year (yoy) in Q2 2023, ahead of 8.9% and 8.7% for leading hotel booking websites Booking.com and Expedia respectively. Furthermore, pricing has been

strong with Airbnb's global average daily rates at around \$170 today versus around \$130 on the eve of Covid. Following some pullback in 2022 and 2023, rates have started to re-infect, increasing 1.4% yoy in the past quarter.

Second, Airbnb's returns are high because of its powerful moat. Airbnb's most valuable asset is its brand, which has become synonymous within the market that it has created. This means that 90% of its traffic is direct rather than from search engines with high associated costs, a major advantage over competitors. It also means that it is the default option for both supply and demand – 64% of its listings are exclusive, which reduces price competition. Moreover, the market that Airbnb has come to lead is inherently attractive – the prize of cracking such a difficult nut – with extremely fragmented supply that is much easier to bargain with compared with the much more concentrated and professionalised hotel industry. About 90% of Airbnb listings are owned by small scale operators and individuals, with just under half single property owners.

As Airbnb continues to scale, these advantages are likely to compound. But there are also plenty of other opportunities to enhance Airbnb's cash flows even further – from selling property management services, technology and data to hosts, to growing the market for “experiences” for guests and longer term and residential accommodation. The extremely diverse and idiosyncratic nature of the home vacation rentals market lends it extremely well to the use of artificial intelligence to enable better matching of rentals with guests and dynamic pricing – and Airbnb's scale will enable it to drive the largest benefits from this and further strengthen its competitive advantage.

We are confident that Airbnb, like many of the great innovative companies born during the last cycle and focused on growth during that period, will be a cash king of the next cycle.

James Dowey

Fund Manager, Global Innovation Team

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We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments

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