Travel
China

November 8, 2017
Ctrip.com International Ltd. (CTRP US)

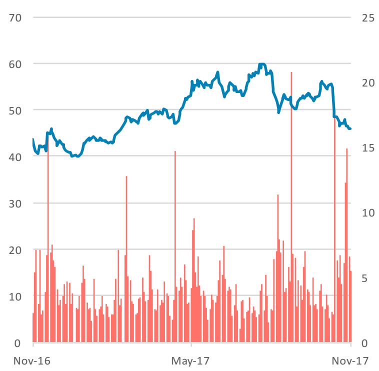
Jeff Dorr
jeff@jcapitalresearch.com

+852 5223 8703

Ctrip.com (CTRP US)

Price	USD 45.90
Market Cap	USD 24 bln
Avg Volume	**4.2 mln**
Days to cover	10.9
Trailing P/E	76

Ctrip.com International Ltd. (CTRP US) last share price in USD (left, blue) and volume in mln shares (right, pink)



Source: Bloomberg November 8, 2017

Ctrip.com International Ltd. (CTRP US)

Stay the Course

- **Ctrip reported strong Q3 results but muted Q4 guidance**
  Ctrip did not provide specific guidance on where the company expects non-GAAP operating margins to settle over the long term but we expect further clarity on this in Q4 results.

- **International will boost profit in air tickets**
  Profit impact from the CAAC regulation should soften, beginning in Q2 2018, as international ticketing growth outstrips the domestic cross-selling problem.

- **No worries about Priceline**
  Investor concern on Priceline's investment in Meituan is overblown. Priceline is merely increasing its exposure to low-end hotels.

- **Margin bump delayed**
  We estimate that the CAAC impact will delay Ctrip's 20-30% non-GAAP operating margins until 2019. Further potential for margin lift can come from franchising agreements with physical stores, new cross-selling opportunities, or more aggressive cuts to marketing or product development expenses.

Cross-Selling Speedbump

By making it easier for consumers to opt out of add-on purchases when buying air tickets, Ctrip has complied with CAAC regulation and will see lower profit on domestic air tickets in Q4 2017 and Q1 2018.

Transportation ticketing remains Ctrip's most important revenue segment, comprising 43% of revenue in Q3. Transportation revenues grew 41% YoY in Q3 but are expected to slow dramatically in the following two quarters due to reduced revenue from cross-selling. Ctrip needs to up-sell on domestic air tickets, where Ctrip earns a fixed ~20 RMB per ticket. As with international tickets, Ctrip earns a percentage of the fare.

Ctrip's Updated Mobile App

Source: J Capital, May 2015.

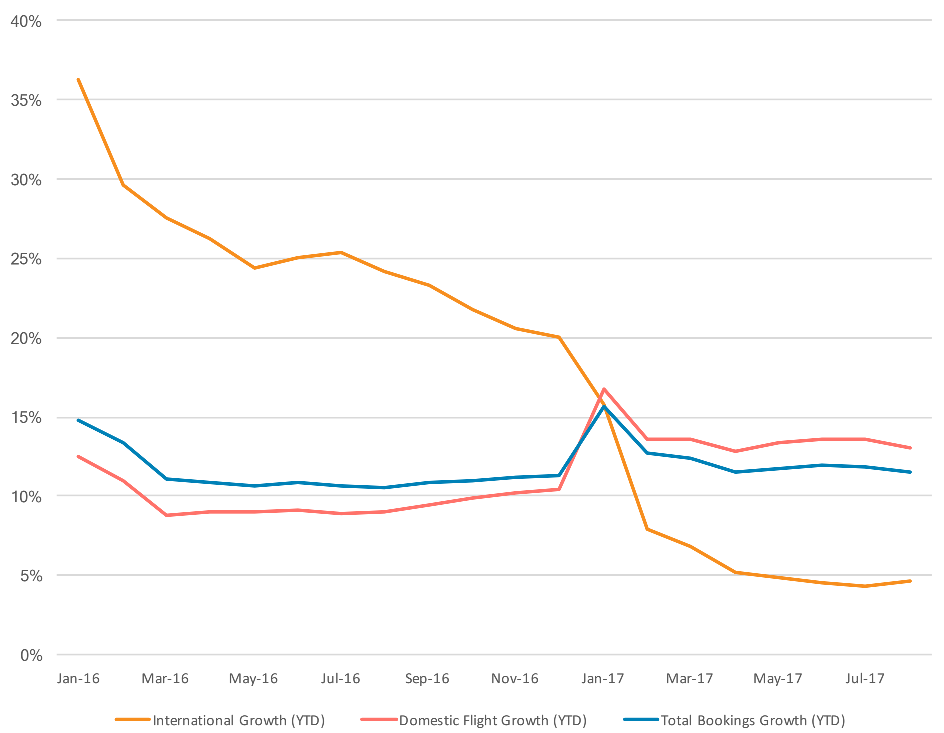
Ctrip's updated mobile app and website make it easier and more transparent for consumers to opt out of cross-selling. For this reason, Ctrip has guided revenue growth to slow in Q4 and for non-GAAP OP margins to fall from 22% (Q3 2017) to ~14-15% (Q4 2017). Management believes that revenue and margin impact should lessen beginning in Q2 2018, as a growing base in international ticketing begins to offset the negative impact.

Travelsky was acquired last year in Q4 2016, and consolidated into Ctrip results beginning in Q1 2017. Travelsky is primarily a European air tick-

Skyscanner's shift to direct booking has been a driver of profit.

eting platform based in the UK. The acquisition significantly increased Ctrip's exposure to international flights. We expect that most of the growth in international ticketing in coming quarters will come from Skyscanner. We learned in Ctrip's Q2 2017 call that 40% of its flight ticketing revenue is from international fights, and that 50% of Ctrip's international tickets now originate in airports outside of China. (Prior to Travelsky's consolidation, Ctrip disclosed in Q4 2016 that 30% of flight ticketing revenue was from international flights.) We think most of Ctrip's current growth in international flights is coming from the Skyscanner acquisition, as Travelsky data indicates only moderate growth in international air travel bookings originating in China.

Chart 1. China Flight Bookings Growth (YTD)



Source: Travelsky

One of the primary drivers of growth for Skyscanner in recent quarters has been a shift to direct booking. Prior to Ctrip's acquisition of Skyscanner in Q4 2016, the OTA functioned much like Kayak.com, where flight bookings were carried out on the websites of different airlines. This made for a cumbersome experience for consumers. Post-acquisition, Ctrip has been working with Skyscanner to allow consumers to book directly on Skyscanner's mobile app and website. Ctrip openly discussed this intention in an inter-

We think the market is over-reacting to the Priceline investment in Meituan. After all, Priceline also owns 9% of Ctrip.

view with Skift as early as November year.[1] This shift has lifted conversion ratios substantially – on the order of 50% according to management on the Q3 2017. Specifically, management disclosed that the number of transactions made through direct booking grew nearly 3x from May to September this year, and that Ctrip enjoys a better commission structure on tickets where direct booking takes place.

Accommodation Revenue – Still growing in spite of Meituan

Accommodation is Ctrip's second most important revenue segment, comprising ~35% of revenue in Q3 2017. Ctrip's accommodation revenue grew 36% YoY in Q3 on strong volume growth, and domestic hotel coverage increased to 590,000 hotels, up from 570,000 hotels in Q2 2017.

Ctrip's result is particularly impressive, given that growth in this revenue segment was organic. Ctrip is actively penetrating lower-tier cities, and management disclosed that Qunar grew over 80% YoY in Tier 3 and 4 cities. Overall, we think this speaks positively to Ctrip's ability to compete with Meituan in lower-tier cities. Management guided revenue growth in this segment to slow to 25-30% in Q4 2017 on account of seasonality.

Priceline's Investment in Meituan – Not a game-changer

On October 19, Meituan announced a USD 4 bln fundraising led by Tencent.[2] Priceline was a new investor in this round, committing USD 450 mln.[3] Although the size of this investment remains much smaller than Priceline's USD ~1.5 bln investment in Ctrip, the investment community has perceived Priceline's move as tantamount to Ctrip losing its grip over the Chinese hotel market.

We think the market's interpretation is an overreaction. In our interviews with hotels and hotel agents, we have consistently heard that Ctrip remains the dominant platform for bookings in the high-end hotel market. In our previous conversations with hotels (see "Online_Travel_Hotels_Push_Back_Against_Ctrip"), we noted that Meituan has actively been pursuing high-end hotel chains. However, we continue to hear that transaction volumes in high-end hotels on Meituan are low due to Meituan's lower-end customer base. Ctrip is the dominant platform.

[1] https://skift.com/2016/11/28/exclusive-ctrip-ceo-on-global-ambitions-skyscanner-buy-and-the-priceline-relationship/

[2] https://www.prnewswire.com/news-releases/meituan-dianping-raises-4-billion-in-new-fundraising-round-300539588.html

[3] https://skift.com/2017/11/01/skyscanner-is-propelling-ctrips-international-growth/

We also don't expect Meituan to adopt aggressive tactics to compete with Ctrip in the near term. In the past, Qunar successfully took share from Ctrip by aggressive couponing, as well as underhandedly paying commissions to hotel front desks for encouraging customers to re-book reservations on Qunar. Our checks to date indicate that Meituan is not engaging in any such tactics. Most of the USD 4 bln raised by Meituan will support business units other than travel and will likely go toward subsidizing loss-making business in food delivery.[4] We do not expect the money to help Meituan compete with Ctrip on couponing campaigns, especially since Priceline still owns 9% of Ctrip – giving Priceline little incentive to support a couponing price war between Meituan and Ctrip.

We think it will prove difficult for Meituan to displace Ctrip in the high-end hotel space, particularly as Meituan lacks a strong presence in flights. We think flight and hotel booking are complementary – particularly for high-end customers who don't have much incentive to switch platforms to save money.

While we expect Meituan gradually to build its presence in the flight market, Ctrip's position in flights is much more difficult to displace today than it was several years ago, when Qunar was taking share from Ctrip. At that time, agents were posting ultra-low fares on Qunar's platform and frequently selling at a loss. These cheap tickets drew consumers away from Ctrip's platform. The agents selling on Qunar made back their money by charging egregiously high fees for altering flight dates/times. The practice upset consumers, and led to airlines refusing to sell domestic tickets to agents. Today, all major airlines sell domestic tickets directly on OTA platforms, which leaves no difference in pricing among OTA platforms. The only way to differentiate today in the flight segment is via improved service, in which Ctrip excels.

How does Priceline benefit from investing in Meituan?

Priceline's investment in Meituan is principally to enable Agoda (a Priceline brand) to partner with Meituan's travel unit.[5] From Agoda's perspective, the investment in Meituan is about getting increased exposure to lower-priced hotels in low-tier cities, where Ctrip has less coverage. At the same time, Meituan is likely to secure access to Agoda's relationships with high-end international hotels. Meituan actively partners with 340,000 hotels, vs. 590,000 hotels for Ctrip.[6]

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[4] https://www.weekinchina.com/2017/11/will-they-deliver/

[5] https://www.sec.gov/Archives/edgar/data/1075531/000107553117000031/a8kmeituaninvestment.htm

[6] https://www.weekinchina.com/2017/11/will-they-deliver/

We expect Ctrip to see 20-25% non-GAAP operating margins by 2019.

Outlook

Ctrip is currently guiding for ~15% Non-GAAP operating margins in Q4 2017, down from the 22% Ctrip achieved this quarter (a level not seen since 2013). We think Ctrip's short-term outlook is weighing too heavily on Ctrip's Q3 2017 achievement and longer-term growth prospects.

In particular, investors are concerned with the expected steep contraction in transportation ticketing growth following the cross-selling restrictions. Ctrip guided transportation ticketing revenue growth to slow to 20-25% YoY in Q4, down from 40%+ YoY growth in the first nine months of the year.

In spite of regulatory headwinds, we anticipate that Ctrip can still attain 20-25% non-GAAP operating margins by 2019 on RMB 42 bln of revenue. We think Ctrip is likely to overcome headwinds from the CAAC policy regulation either by finding new cross-selling opportunities, growing margins via franchising agreements in physical stores, or more aggressively cutting sales and marketing or product development costs. We expect Q1 2018 to be the trough for Ctrip and the company's outlook to improve materially into H2 2018.

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