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Coverage Initiation

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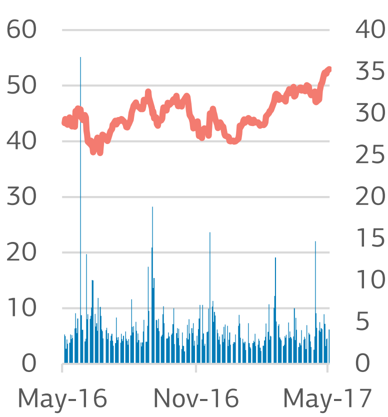
Ctrip (CTRP US)

Price	USD 52.97
Market Cap	USD 27.4 bln
Rating	**BUY**
Price Target	**USD 67.50**
Difference	27%
Days to cover	7.7
Trailing P/E	N/A

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



Source: Bloomberg May 8, 2017

Ctrip (CTRP US)

A Short-Term Long, Long-Term Short

- **24–36 months of upside**
  Over the next 2–3 years, we think upside remains on Ctrip as margins continue to recover following the end of its price war with Qunar.

- **Strong Q1**
  Despite a February slowdown in international flights, total flight growth YTD was up 13% YoY through February. Qunar should also benefit from easy comps in H1 2017 due to the boycott by several airlines in H1 2016.

- **Non-GAAP operating margins to 23%**
  In the context of limited competition, we anticipate non-GAAP OP margins to expand to 23% by 2018, up from 10% in 2016. We expect revenue growth of ~34%, through 2018.

- **No real moat**
  Long term, we have serious concerns about competition from Alibaba's Fliggy. Fliggy recently announced GMV of RMB 100 bln 2016 against Ctrip's (and merged Qunar's) GMV of RMB 430 bln over the same period. Fliggy, in GMV terms, is ~25% the size of Ctrip.

- **Valuation**
  We value Ctrip at 30x our projected 2019 earnings, or USD 67.50 per ADS on a fully diluted basis. We have not constructed a detailed downside scenario – but if a pricing war resumes and non-GAAP OP margins return to mid single-digit levels, we think the stock could trade as low as USD 20-30 per share long term.

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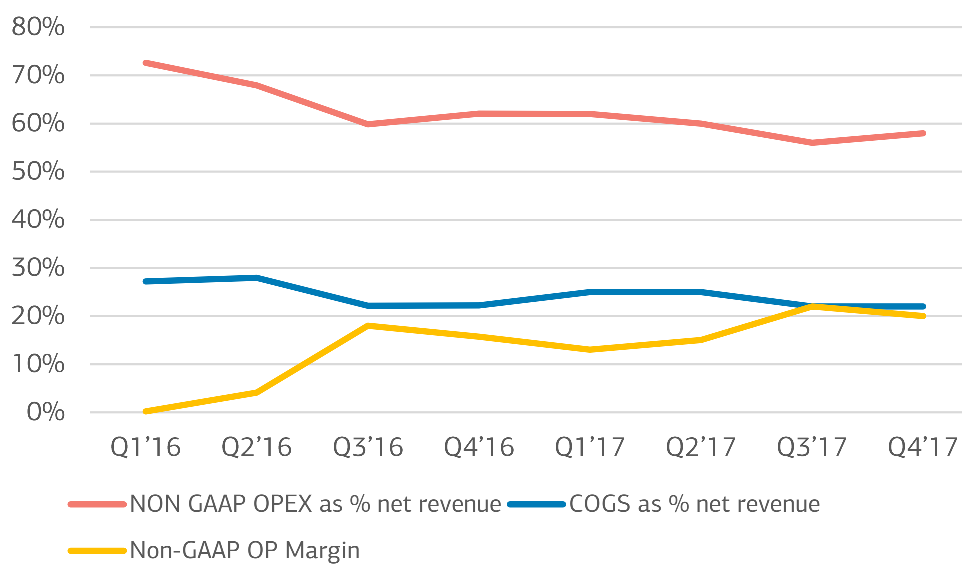
Ctrip's Turnaround

Since the acquisition of Qunar, Ctrip has been gradually orchestrating a turnaround. Revenue growth has been strong, and the company's margin structure has improved, as scale has reduced operating costs and reduced competition has supported Ctrip's top line. Gross margins and non-GAAP margins have expanded accordingly.

Chart 1. Ctrip's Improving Margin Structure



Source: Company Reports, J Capital

With limited competition in the near term, we expect continued margin expansion. We are forecasting gross margins to expand to 77% in 2017, up from 75% in 2016. We expect non-GAAP operating margins to nearly double in 2017, to 17% from 10% in 2016 due to enhanced scale and a further reduction in vouchers.

Q1 2017 – reporting on May 11

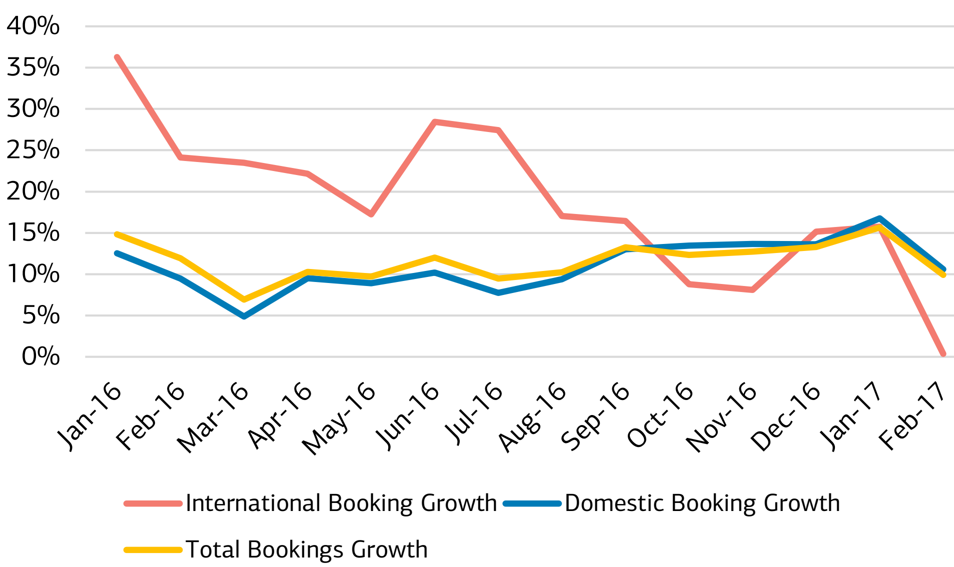
Ctrip is scheduled to announce Q1 results on May 11. We suspect results will be in line with Ctrip's guidance. The two largest revenue drivers for Ctrip are hotels (~37% of revenue) and transportation tickets (45% of revenue). Transportation tickets comprise flights (roughly 85% of transportation ticketing revenue) as well as rail and bus tickets (approx. 15% of transportation ticketing sales).

We use Travelsky flight data for a broad understanding of the health of

China's travel industry. Because the data are specific to domestic airline carriers, however, they do not perfectly predict Ctrip's results. Travelsky's data exclude flights on international carriers to and from China, hotels, and domestic travel conducted by bus and rail.

Nevertheless, Travelsky data indicate that China ended 2016 strongly, with Q4 averaging over 12% growth YoY. In Q1 2017, travel was exceptionally strong in January, growing nearly 16% YoY since Chinese New Year came in January for 2017. In February, flight data tapered off, particularly in the international segment, which registered no growth year over year. Combined YTD growth for January and February show flights increasing 13% YoY, in line with 2016 figures. We expect that this growth, combined with easy comps for Qunar after major carriers boycotted the platform in H1 2016, should help bolster Ctrip's results for Q1 2017.

Chart 2. China Flight Bookings Growth by Month (YoY)



Source: Travelsky

Why Ctrip is Vulnerable

In our earlier work on Ctrip, we wrote at length on how Qunar and Elong were able to quickly take share in the hotel and air ticketing space in China. Following share gains, Qunar embarked on a price war with Ctrip. The price war crimped Ctrip's margins in 2014–2015 and cost Ctrip billions in market cap. Ctrip solved the issue by buying controlling stakes in both competitors, diluting shareholders in the process.

A cursory glance at the balance sheet shows that Ctrip's biggest asset is goodwill, which comprises some 40% of total assets. Compare this to Priceline, where goodwill comprises some 12% of assets. Whenever a new competitor arises, Ctrip has historically solved the problem via acquisition. The balance sheet reflects that story.

One question continues to daunt us — how is it that Booking.com has managed to hold onto its market share and maintain firm pricing, whereas Ctrip has had two former competitors eat into profits? We don't have the definitive answer, but one explanation might be the way the two companies differ in acquiring traffic. Priceline, for instance, acquires most of its traffic via search engine (primarily Google) — and it spent USD 3.5 bln to do so in 2016 or ~33% of revenue; see Priceline's 2016 Annual Report. According to Baidu's annual report, Ctrip spent only RMB 630 mln on marketing services on Baidu, or USD 91 mln — approximately 3% of Ctrip's revenue; see Baidu's 2016 Annual Report. About three quarters of Ctrip's bookings come via its mobile app, presumably most of which is organic traffic.

Priceline's hefty budget for search results combined with its ability to successfully convert clicks into transactions is difficult for competitors to replicate. A competitor might have to spend a similar amount of money on search engine advertising to direct sufficient traffic to its website without necessarily converting that traffic into bookings. Ctrip, on the other hand, while ostensibly enjoying savings on traffic acquisition, is vulnerable to any competitor that can generate its own traffic, and that competitor may not need USD 3.5 bln of advertising spend to do so.

Our interviews with hotel managers in China speak to how Online Travel Agency (OTA) competition in China works. Hotels like to work with as many OTA platforms as possible. Getting set up on a platform typically takes 7–10 days and involves uploading pictures, room descriptions, and establishing how many rooms are available for the OTA channel. The cost of partnering with an additional OTA is low. A hotel with 100 rooms might assign 20 rooms that are available to the OTA channel. For those 20 rooms, it's a first come, first serve basis for the OTAs. Ctrip does sometimes secure guaranteed rooms, but the numbers are generally small. For hotels we spoke with, Ctrip might get 1–2 rooms guaranteed out of 20 that are available to the OTA channel.

There are two types of bookings in China: extranet and direct. For most hotels, bookings are done via an extranet platform provided by the OTA. The extranet is similar to a browser window and does not integrate with the central reservation system of the hotel. Staff at the front desk access the extranet platforms of Ctrip, Fliggy, or Qunar. As bookings come in, staff see an alert on the computer, check availability at the hotel, and then accept the booking. This type of booking is called an extranet booking and requires that the end customer wait for confirmation after booking or until the person at the hotel front desk is able to confirm the booking.

There is a second type of booking, which occurs when a hotel's central reservation system integrates directly with Ctrip or Fliggy's platforms. Under this system, Ctrip and Fliggy can see all of the available room inventory (or the rooms available to the OTA channel). Chain and international hotels tend to use these systems, which generate instant transactions.

Competitive wall: user traffic

User traffic appears to be the main factor in winning share in hotel bookings. In the past, Ctrip has been able to ward off rising competition by taking controlling stakes in its competitors. The problem arises when Ctrip encounters a competitor who is unwilling to sell.

We think that new competitor is Alibaba's Fliggy. While Fliggy is only 25% the size of Ctrip today, we were surprised to learn from our interviews that for one hotel chain with over 450 properties, Fliggy has actually displaced Ctrip in room nights in just two years. For reasons such as customer data, payment systems (Alipay), shopping (Taobao), and others that we detail below, we think Alibaba has strong incentives to continue supporting Fliggy's growth.

Fliggy appears on the home screen of the Taobao and Alipay apps, which puts the Fliggy app on most phones in China by default. By Fliggy's count, it has over 200 mln registered users in China, which is higher than Ctrip's 70 mln (excluding Ctrip's recent [acquisition of Skyscanner]).

Hotel Field Findings

Fliggy growing in some mid-tier chains

Based on our most recent visits with hotel operators in Shenzhen and Guangzhou, we summarize our key findings on Ctrip's hotel business and competitive positioning:

- Most hotels we met charged prices in the RMB 200–300 range. Those hotels reported low volumes from Fliggy but higher volumes for Ctrip, Qunar, and Meituan. However, the two high-end hotels we met, with prices in the 300–500 RMB range, both reported relatively higher and growing volumes from Fliggy

- Hotel managers prefer to have a presence on multiple OTAs to lessen dependency on any single platform. The cost of signing up with a new OTA platform is negligible.

- Ctrip typically charges 10–15% commission, but we heard as low as 8% and as high as 20% in our checks. Fliggy is charging 5–8% currently, but hotels widely expect Fliggy to gradually hike commissions. Operators do not believe Ctrip will hike commissions. Commissions with Ctrip have been stable for years, and hotel operators are already struggling for profits. Foreign OTAs such as Agoda and Expedia frequently charge 20% commissions, but volumes are low and users of these sites tend to book far in advance, which gives hotels some visibility on occupancy levels. Customers on Chinese platforms tend to book on mobile devices and with less lead time.

- Room pricing to consumers is consistent across all platforms, unless a particular OTA is offering coupons. For instance, if the hotel is offering a room rate of RMB 400, that price is consistent across all OTAs. However, if, say, Ctrip wants to offer customers an extra incentive, Ctrip can offer a voucher for 20 RMB. The customer purchases the voucher for RMB 20, and the next time that customer books a hotel with Ctrip, he/she receives a RMB 50 discount.

- OTAs with fatter commissions have a structural advantage. Let's examine a hotel room selling for RMB 400. Suppose Ctrip takes a 20% commission, while Fliggy takes a 10% commission. After the stay is completed, Ctrip collects RMB 80, while Fliggy receives RMB 40. In theory, Ctrip can still offer customers vouchers of RMB 80 and break even, whereas Fliggy can offer only a RMB 40 voucher to break even.

- Hotels cannot choose which platform they allocate rooms to. For instance, if they have 10 rooms allocated to OTAs daily, those 10 rooms are filled on a first-come, first-served basis. If a booking comes in from Ctrip, the hotel can't reject the order and wait for a booking from a competing OTA with lower commissions

- Commission structures are complex. Ctrip in some cases uses ratcheting commissions, where commissions widen with increasing volume. In addition, there is usually a base commission to get a hotel property listed on a platform and then additional commissions for better placement only on initial search for a hotel, but also for listing once a user selects a hotel and chooses a vendor to purchase from. Some vendors, including Ctrip, also require deposits from hotels.

- Several hotels noted that Qunar competed unfairly against Ctrip in the past. Qunar actively recruited front desk employees at hotels and offered them payment for convincing travelers to cancel their reservations with Ctrip and book instead via Qunar for a few less RMB. To date, Fliggy is not using these tactics.

- During Ctrip's price war with Qunar, hotel commissions did not change. Ctrip and Qunar offered competing discounts on hotels directly to consumers rather than competing with low commissions to the hotels.

- High-end hotels that previously leaned on Qunar for bookings now *only* get bookings via Ctrip. Search results for high-end hotels have been deprioritized Qunar in an effort to shift these bookings to Ctrip. One five-star hotel we interviewed (best available room rate of RMB 488) reported that, from 2014–15, it received 800–1,200 bookings from Qunar per month. Today, the hotel receives only 100 from Qunar with the remaining bookings coming mostly from Ctrip. In the first month of signing with Fliggy, the hotel booked 300 rooms.

- We interviewed one hotel chain with roughly 450 properties spread across China, each with approximately 200–300 rooms. Rooms cost RMB 300 per night. This hotel group has strong occupancy ratings and relies on the OTA channel for only ~5% of its bookings. The hotel group started working with Fliggy in late 2014. By late 2016, Fliggy had displaced Ctrip as the hotel chain's leading OTA platform. The shift was attributed to increasing traffic from Fliggy. Both Ctrip and Fliggy compete for bookings on a first-come, first-served basis. Ctrip charges 20% commission to the hotel group vs. Fliggy at 5%. Fliggy charges additional fees for better listing placement. In aggregate, however, Fliggy is still significantly less expensive.

- Fliggy's "Hotel of the Future" program enables consumers to check into hotel rooms without paying deposits and leave without having to undergo the hotel's room inspections. Hotel chains that use Fliggy's Hotel of the Future platform like Fliggy for several reasons: they can reduce front desk staff expenses via direct booking, because employees aren't needed to monitor incoming bookings on an extranet platform. In addition, staff time at the front desk is conserved due to expedited customer check-in and check-out. Finally, if customers don't show, their credit score is negatively impacted on Sesame Credit. This incentivizes customers to show for their reservations, and reduces the cost of no shows for hotels.

- For all users on Fliggy platform, commissions on Fliggy are lower — generally in the 5–8% range versus Ctrip's 10–15%.

Fliggy's size and positioning

Fliggy is Alibaba's answer to capturing the business of China's leisure travelers. Compared with Ctrip, Fliggy generally attracts a younger demographic, with some 83% of Fliggy's user base was born after 1985. Market perception is that Fliggy has a stronger presence in the flights business compared with hotels, but our ground checks suggest this is changing as Fliggy builds out a stronger presence in the hotel space.

Table 1. Hotel Market Share by Transaction Value

	2015 Q2	2016 Q1
Fliggy	6.8%	7.1%
Elong (owned by Ctrip)	10.9%	9.4%
Qunar (owned by Ctrip)	17.0%	20.9%
Ctrip	45.2%	43.6%
Others	20.2%	19.0%

Source: Analysys; Note: Fliggy charges one-third the commissions of Ctrip on hotels, hence this market share data likely understates Fliggy's share in GMV terms

Table 2. Air Ticket Market Share by Transaction Value

	2015 Q1	2016 Q2
Sina Weibo	4.4%	4.0%
Fliggy	12.3%	15.5%
Qunar (owned by Ctrip)	25.1%	24.2%
Ctrip	36.6%	36.2%
Others	21.6%	20.2%

Source: Analysys;

Market share data from Analysys provides a reference but is probably based on revenue rather than GMV. We think that market share measured in GMV terms is the more relevant figure, as lower commission structures can distort market share data captured by Analysys.

Fliggy announced in November 2016 that it had reached RMB 100 bln in GMV with approximately 1,000 employees. Ctrip disclosed GMV of 430 bln in 2016, making Fliggy nearly 25% the size of Ctrip in GMV terms. Fliggy also disclosed that it has ~220 mln users (more than Ctrip's 70 mln registered users in China). This user base is a substantial increase from 2015, when Fliggy reported having 100 mln registered users. According to Fliggy's announcement, the platform also enjoys about 10 mln daily users.

As of early 2017, Fliggy is reportedly working with some 250,000 hotels in China and is attacking the mid- and high-end hotel space with its Hotel of the Future program.

Fliggy's Hotel of the Future program is made possible by direct booking specifically for hotels that utilize Beijing Shiji (002153 CH) as their central reservation system. Beijing Shiji provides hotel IT systems with capabilities like central reservation, loyalty, and payment systems as well as data analytics. Using this system, Fliggy can directly integrate into a hotel CRS systems and provide instant bookings. Beijing Shiji is the software vendor for many international hotel groups in China, including Grand Hyatt, Sheraton, Hilton, Shangri La, Marriott, Peninsula, Accor, etc. According to Beijing Shiji's investor relations website, it has 60–70% market share in starred hotels in China.

Beijing Shiji Information is known in the CRS industry as having a leading position in China's five-star hotel market. Alibaba's relationship with Beijing Shiji began in 2014. Following Alibaba's IPO, the internet giant invested USD 450 mln for a 15% stake in Beijing Shiji Information Technology. Beijing Shiji is currently servicing ~11,000 hotels across China. Most of these hotels are 4–5 star facilities, and are likely high-profit hotels for Ctrip.

With 1,000 employees, can Fliggy compete with Ctrip?

Ctrip bulls contend that Fliggy's employee base of 1,000 can't provide sufficient resources to effectively compete with Ctrip's 37,000 employees. But Fliggy's is a different model:

- Interviews have confirmed that Fliggy contracts with outside parties to sign up hotels on its platform, whereas Ctrip and Meituan have these resources in-house. Fliggy, through its cooperation with Hotel IT software providers like Beijing Shiji may also save on headcount

- Fliggy may also outsource its customer service team.

- Interviews with hotels indicate that Fliggy operates as a platform model, which requires less negotiation with salespeople.

Table 3. Ctrip Employee Count

	2012	2013	2014	2015	2016
Management	1,200	1,300	1,800	1,700	2,300
Customer Service	10,900	14,200	16,900	16,000	14,500
Sales & Marketing	2,200	1,300	1,700	1,900	5,300
Product Development	4,700	6,200	11,800	11,400	14,900
Total	19,000	23,000	32,200	31,000	37,000

Source: Annual Reports;

For those who believe high employee count is imperative to OTA growth, we argue that Ctrip's customer service count has actually declined since 2014 in spite of a near tripling of gross revenues, from RMB 7.7 bln in 2014 to RMB 20 nln over the same period.

Note that the bulk of Ctrip's employee base is in customer service and product development. Fliggy may save on staff expense by outsourcing its customer service centers. With regard to employees in product development, Fliggy may also save on some headcount by overlapping some aspects of development with other parts of the Alibaba group.

The discrepancy in employee efficiency may partly result from Fliggy's approach. Hotels we interviewed spoke to said Fliggy views itself as an open marketplace. Fliggy's objective is to sign up as many hotels, airlines, and other travel providers as possible and allow these merchants to pay fixed commissions for listing. This contrasts with Ctrip, where contracts are negotiated on an annual basis and might involve discussions around deposits paid to Ctrip, guaranteed rooms, ratcheting price terms based on volume, and other complications. Annual business terms require less negotiation, leading to greater efficiencies with sales staff.

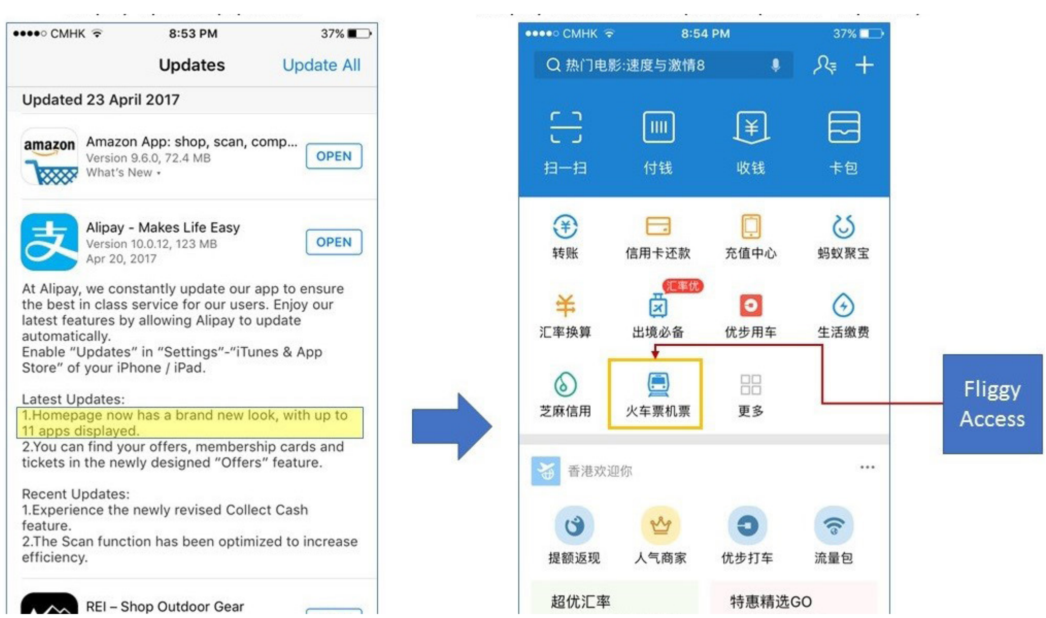
Fliggy, Ali Traveling Merchant, and Alibaba's Incentive to Grow the Travel Business

Alibaba Group currently has two travel platforms aimed at the Chinese traveler. The first is Fliggy (飞猪), which is aimed at leisure and outbound travel. The second platform might translate to Traveling Merchant (阿里商旅). This platform is aimed at corporate travelers. Both Fliggy and Traveling Merchant are heavily integrated with Alipay.

Although Fliggy is making inroads into Ctrip's travel market, the company may not necessarily be seeking near-term profits. Alibaba is fighting a war with Tencent on payment systems and user data — both of which are invaluable to their long-term strategies. Users frequently use mobile payment systems and bookings while traveling, so the travel industry and mobile usage go hand-in-hand. Thus Ctrip may be facing a competitor that is willing to offer low pricing and sacrifice near-term profitability for long-term user data and the proliferation of its mobile payment system. This is consistent with what we heard from hotels we spoke with in mainland — Alibaba frequently charges 5% commissions for new customers, while Ctrip charges 10–15%.

Although profitability for Fliggy is most likely low, the Alibaba group appears to be taking steps to increase user interaction with the platform. In Alipay's latest mobile app update, the Alibaba group brought Fliggy's plane and train booking systems to the home screen. This feature was previously buried several layers down. Alipay is one of the most frequently used applications in China and moving Fliggy to the home screen suggests that Fliggy is a priority for the Alibaba group. We note that Alibaba is growing its Alipay network overseas, where 110,000 shops currently accept Alipay.

Fliggy also remains tightly integrated with Alibaba's Taobao app, and is also presented on the Taobao home screen.



Alipay's April 20th update, which added Fliggy to its homescreen | Source: J Capital, April 2017.

Alibaba sees a tight relationship between its shopping, travel, and payment platforms. The following from an interview with Sherri Wu, Chief Strategy

Officer of Fliggy, summarizes the strategy:

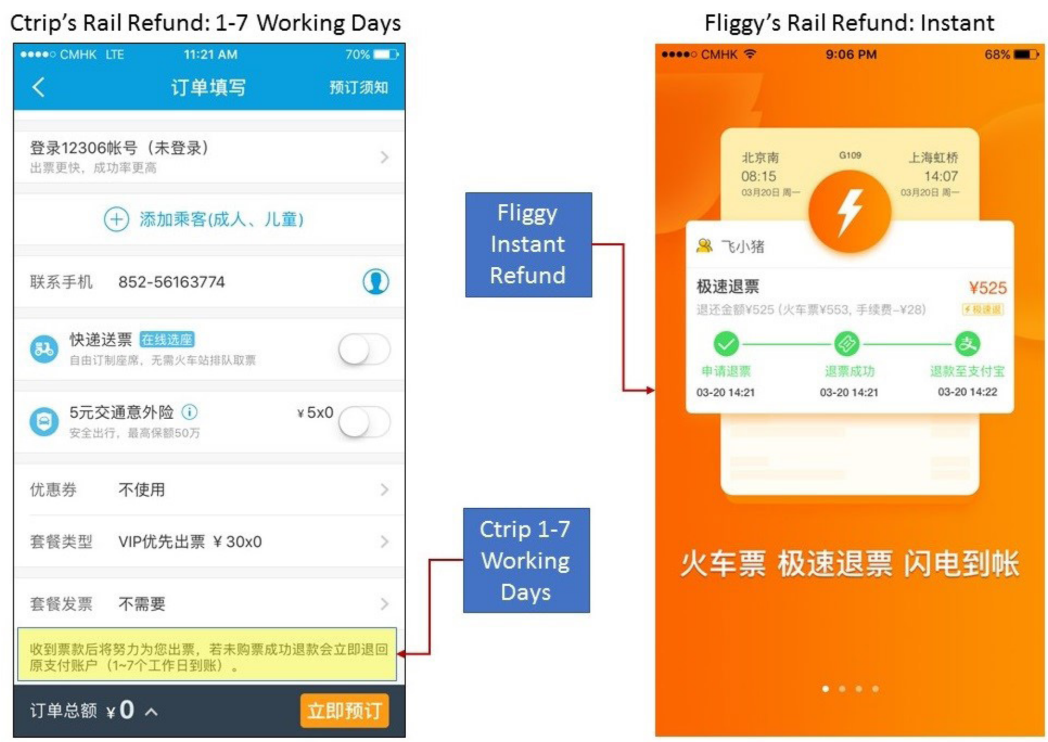
> "We help Chinese consumers shop from within [Fliggy]. When they get to a destination they can shop at the local shops with their coupons they get from [Fliggy].
>
> We're actually doing it even one step further, like truly O to O (online to offline), with Shilla, which is a duty-free shop in South Korea. They opened a small global store with us and now we have the online coupon they can get which they can shop in the local places.
>
> Essentially, what they can do is before they go, they will look into 'What I can buy there?', they plan the whole thing then once they get there, they can use their coupon and discount to buy them.
>
> We're also working with them to see if they will send all these things to these people's hotel room. They'll be like, 'Hands free, I'm going to buy more.'
>
> We want to develop more experiences like that, by working with suppliers. We're also working with few large merchants in US as well and we will probably push the promotion out before Chinese New Year."
>
> Sherri Wu, Former Fliggy Chief Strategy Officer [Source]

Alibaba has been active in establishing platforms overseas such as the Malaysia Tourist Pavilion (ATP), in which travel merchants from Malaysia can directly sell products and services on Fliggy. Such products include things like local tour and hotel packages, shopping and dining vouchers, entrance tickets, and transportation and communication services. The concept is that users are engaged in the Alibaba ecosystem via shopping, traveling, and payment.

For hotels enrolled in Fliggy's Hotel of the Future, users can check in without paying room deposits and check out without China's ubiquitous and time-consuming requirement of a room inspection, all facilitated by Alipay's Sesame Credit Score. Room damages or any items consumed are billed to the customer's Alipay account. Hotels also benefit from the program, which requires them to dedicate fewer staff to process customer check in and check out. They can also obtain information on the customer's historical record of room cancellation. For some hotels, consumers can also preview rooms virtually before booking.

In addition to Fliggy's Hotel of the Future program, Fliggy also has "Park of the Future" (未来景区) built into the application. This allows users to purchase tickets to local parks and attractions without lining up at frequently crowded tourist destinations. Payment on "Park of the Future" is facilitated by Alipay.

Other small innovative features on Fliggy include the ability to refund unconfirmed train tickets in a matter of minutes, vs. Ctrip's 1-7 working day waiting period.



A comparison of Ctrip's rail refun policy with Fliggy's. Note that both policies apply to tickets booked but not yet issued. | Source: J Capital, April 2017.

Alibaba's corporate travel platform

Fliggy is Alibaba group's leisure travel platform, but Alibaba has also created a corporate travel platform dedicated to small- and medium-sized enterprises. [The idea behind the platform](#) is to allow business travelers to engage in travel without advances for money, receipts, or submitting expenses, all facilitated by Alipay linked to a corporate credit account in Sesame Credit.

Ali Traveling Merchant allows staff at small businesses to save time on details of expense reports and also improves cash flow by allowing businesses to pay by credit. Alibaba would like each business customer to have its own Sesame Credit Score and pay for travel on credit via Alipay. Business travelers would enjoy many of the benefits that Fliggy consumers also enjoy, such as expedited check in and check out at hotels that support Hotel of the Future. Travelers can also submit approvals for expenses in real time on a mobile app. Some Chinese media has already suggested that Alibaba's Traveling Merchant platform may have already overtaken Ctrip as China's leading corporate booking platform for travel.

Meituan-Dianping

Meituan-Dianping was formed as a merger in late 2015. Meituan was originally backed by Alibaba, while Dianping was backed partly by Tencent. The companies were focused on restaurant deals and reviews, food delivery, movie tickets, group buy services, hotel bookings, and other O2O services. In early 2016, Alibaba sold its stake in Meituan-Dianping, though Tencent remains an important backer.

Meituan-Dianping is a competitor to Ctrip in the hotel business. Although Meituan is growing quickly, its focus seems to be in mostly low end hotels. For this reason, we consider Meituan's business to be less of a competitive threat. Meituan is also a relatively small competitor in flights, booking only 2 mln flights in 2016.

Investors frequently assume that Meituan just provides group-buying deals on hotels, but Meituan is moving toward a booking model more closely resembling that of Ctrip.

> "In July [2015], regular hotel bookings constituted 30% of Meituan's hotel sales and 70% was group buy, mainly from local users. Our goal is to get half-half between regular bookings and group buy this year [2016]." [Source]
>
> —Strategic Partnerships Director, Meituan Dianping Hotel & Tourism

A few other noteworthy details emerged in Meituan's 2016 annual announcement that bear mention. Meituan-Dianping booked 130 mln hotel room nights in 2016, with 320,000 hotels in network, as well as 1 mln air tickets. The 130 mln room nights implies a substantial increase from 2015, when Meituan booked 33 mln room nights in the first half. This makes Meituan one of the largest platforms by room nights in China. We don't have a precise number of Ctrip for 2016, but for 2015, we estimate that room night bookings among Ctrip, Qunar, and Elong totaled approximately 220 mln.

One caveat for Meituan — Meituan's bookings include hourly bookings, so the two figures aren't directly comparable.

Table 4. Room Nights by Platform

	2012	2013	2014	2015
Elong	16	26	34	43
Qunar	7	16	32	80*
Ctrip	28	41	66	99
Total	52	83	133	222

Source: Company Reports, TranscriptsNote: * Includes property management system volume

In its 2016 announcement, Meituan emphasized that its bookings on starred hotels increased 300% in 2016, indicating that the brand may be gradually moving up market in hotels. Meituan has also rolled out overseas accommodation at some 120,000 hotels, 255 of which are high-end hotels, including brands such as Marriott, Fairmont, Hyatt, Wyndam, and W Hotel. Meituan's user base is 60% female, with 53% of users born after 1990, and another 34% born after 1980. About 70% of users are under 27, and Meituan is strongest in second and third-tier cities in China. This user base is different than that of Ctrip, which generally caters to less price-sensitive consumers.

Accounting Concerns

The following describes some of our observations about Ctrip's accounting. Of these, we think Ctrip's shifting of eLong from the equity method into AFS is probably the most significant. Ctrip is shifting a line item that lost RMB 700 mln in 2016 into "other comprehensive income" going forward.

Ctrip's lack of price/volume disclosure

Ctrip is the only public OTA platform we've examined that does not offer any directional volume growth, pricing, or GMV guidance to investors. Priceline, Expedia, and MakeMyTrip all disclose some form of transaction volume, room nights, or volume growth for flights and hotels. Ctrip only provides GMV guidance once annually, and does not break out GMV by category. Ctrip formerly disclosed guidance on unit growth for flights and hotels, but dropped the practice following the acquisition of Qunar. Without this data, we feel investors are left guessing at Ctrip's growth drivers.

Shifting eLong into AFS investments

In 2016, Ctrip booked an equity pick-up loss of in eLong of RMB 723 million. Ctrip had acquired a 38% stake in eLong in 2015 and was accounting for eLong under the equity method. In May 2016, however, eLong was taken private and became the wholly owned subsidiary of E-dragon Holdings. Ctrip's shares in eLong were then converted into the ordinary shares and preferred shares of E-dragon Holdings. The ordinary shares in E-dragon continue to be accounted under the equity method, while the preferred shares are accounted for under available for sale securities (AFS).

As most of the value in E-dragon is accounted for under preferred shares (booked under AFS), Ctrip has effectively shifted losses from eLong into other comprehensive income. As most investors value Ctrip on earnings *before* other comprehensive income, we think Ctrip has essentially shifted a money losing investment away from the earnings line.

Dilution

In the latest 20-F, Ctrip discloses its dilutive securities for 2016 that were excluded from its diluted share count. Because 2016 was a loss-making year, all convertible securities were excluded from Ctrip's diluted share count.

Table 4. Ctrip Investments

	2015	2016
HTM Investment		
Long term time deposit	1,020,425	1,059,813
AFS investments		
China Eastern Airlines	—	3,293,478
Tujia	2,876,749	3,081,586
Hanting	1,116,231	1,984,037
eLong	—	*1,877,945*
LY.com	1,745,310	1,523,436
MakeMytrip	—	1,519,309
eHi	793,869	612,310
Tuniu	430,659	252,746
Easy Go	527,302	228,318
Others	316,743	94,311

Table 4. Ctrip Investments, cntd.

	2015	2016
Equity method investments		
BTG	—	2,498,763
eLong	*2,632,145*	*235,138*
Homeinns	961,773	—
Investment funds	261,521	616,161
Others	199,527	764,138
Others — cost method investments	988,268	891,333

Source: Annual Reports

We are struggling to reconcile how Ctrip calculates dilution for its most recent 2022 notes issued in September 2016. Ctrip raised USD 975 mln in this issue at a conversion price of USD 65.49. Based on these figures, we estimate that around 1.9 mln ordinary shares would be created upon conversion. However, Ctrip's latest annual has this figure at ~575,000 ordinary

Table 4. Dilutive Securities est. by Ctrip and JCap

	Ctrip	JCap
2017 convertible senior notes	435,248	435,248
2018 convertible senior notes	2,551,360	2,551,360
2020 convertible senior notes	1,608,985	1,608,985
2025 converibile senior notes	935,550	935,550
2022 convertible senior notes	*559,282*	*1,860,885*
Priceline convertible 2019 notes	1,536,338	1,536,338
Priceline covertible 2020 notes	599,400	599,400
Priceline convertible 2025 notes	912,919	912,919
Priceline convertible 2022 notes	14,341	14,341
A long-term equity investment firm notes	912,919	912,919
Outstanding weighted average stock options	3,678,030	3,678,030
Sold Warrants	303	303

Source: Annual Reports

shares. We are seeking clarity with Ctrip on the discrepancy. On our count, we assume about 11.4 mln ordinary shares created as a result of convertibles.

Risks to Our Views

Chief downside to our thesis would be Fliggy gaining market share faster than we expect in the hotels business or initiating a price war with Ctrip via vouchers. We do not think Fliggy has built sufficient scale or momentum for this to occur — at least in the near term.

Upside risk to our thesis hinges on Ctrip's ability to increase take rates with hotels. On the flight side of the business, we think take rates will remain stable at ~4–5%. However, take rates on the hotel business are less standardized, varying from 5% up to 20%. We heard consistently that Ctrip's international peers in China such as Booking.com, Agoda, and Expedia earn 20% take rates. If Ctrip's bargaining power were to strengthen with hotels, we could see material upside in revenue and margins from Ctrip's hotel business. Although the hotels we interviewed unanimously rejected the idea of increased take rates from Ctrip, our sample size is admittedly small. We suspect that if Ctrip were able to improve terms with hotels, margins would have material upside from today's consensus.

Valuation

We currently forecast a blue sky scenario to value Ctrip, in line with management guidance. We think that Ctrip's business will face competitive pressures from Fliggy possibly in 2019, and will readjust our forecast when we see Fliggy becoming more of a direct threat. For the time being, Fliggy does not appear to be engaging in a coupon price war with Ctrip, or partaking in any strong-arm practices to redirect consumers from Ctrip to the Fliggy platform (see Field Notes section on Qunar's prior business tactics).

When and if Fliggy reaches 50% of Ctrip's GMV we will re-evaluate. In 2014, Qunar's GMV was 84 Bln against Ctrip's ~152 Bln. Qunar did not disclose GMV figures in 2015, but we can assume Qunar was probably at least half the size of Ctrip before Ctrip took action on buying Qunar. With Fliggy only 25% the size of Ctrip, we think Ctrip still has breathing room before potentially feeling any direct impact.

For the next two years, we think Ctrip management has successfully implemented a turnaround with the acquisition of Qunar. We anticipate that results will remain strong over two years, and forecast a topline CAGR of 33% through 2019 while non-GAAP OP margins expand to 24% — up from 10% in 2016.

We value Ctrip on 30x our projected 2019 earnings, for a value of USD 67.50 per share.

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