eLong Inc. (LONG)

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Executive Summary

eLong, Inc. (Nasdaq: LONG - News) is in mobile and online accommodations reservations in China offering consumers a network of more than 400,000 properties worldwide. eLong technology and services enable travelers to book hotels, guesthouses, apartments and other accommodations, as well as air and train tickets, through its mobile and tablet applications (m.eLong.com), websites (www.eLong.com). eLong's largest sharehholders are Expedia, Inc. (Nasdaq: EXPE) and Tencent Holdings Ltd. (HKSE: 0700).

TICKER:	LONG
RATING:	SELL
TARGET PRICE:	$4.11
POTENTIAL UPSIDE:	-75.2%
TIME HORIZTION:	12-24 M

Unlike Ctrip and Qunar, eLong essentially only offers hotel booking services (air-ticket volume is very low at eLong). Due to the increasing competition in the hotel OTA space, we saw its operating margin drop significantly compared to 3 years ago. For Ctrip and Qunar, the hotel price war brought a higher market share for both companies despite decreasing margins. However, in eLong's case, revenue growth is behind the online travel industry growth rate. We don't believe eLong's business model is sustainable and we have a 12 month target price of $4.11 which translates to a 75% downside.

Key Statistics

	12 Months Dec-31-2012A	12 Months Dec-31-2013A	12 Months Dec-31-2014A	12 Months Dec-31-2015E	12 Months Dec-31-2016E
Total Revenue	119.40	166.78	175.13	187.03	225.28
Growth Over Prior Year	27.0%	35.7%	7.6%	(0.3%)	20.5%
Gross Profit Margin %	72.5%	74.2%	67.7%	-	-
EBITDA Margin %	(6.4%)	(15.3%)	(28.6%)	-	-
EBIT Margin %	(8.6%)	(17.5%)	(31.3%)	-	-
Net Income Margin %	0.1%	(16.6%)	(24.8%)	(54.6%)	(1.2%)
Diluted EPS Excl. Extra	-	(0.80)	(1.22)	(2.85)	(0.07)
Diluted EPS Excl. Extra	(98.9%)	-	-	-	-

[1]

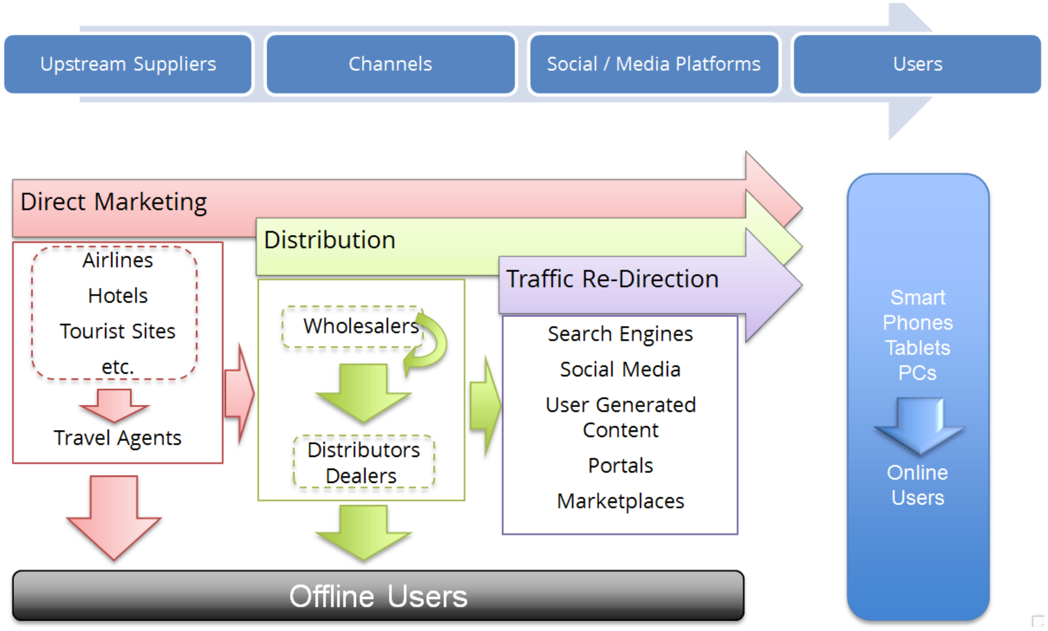
[1] Capital IQ

Contents

Industry Trend Recap

China's online travel industry has grown at an impressive rate in recent years. The industry is a subsector of the O2O (online to offline) market, where consumers go online to shop for physical services which they enjoy offline. We believe this industry is attractive based on multiple macro tailwinds despite of the recent intensifying competitive environment.

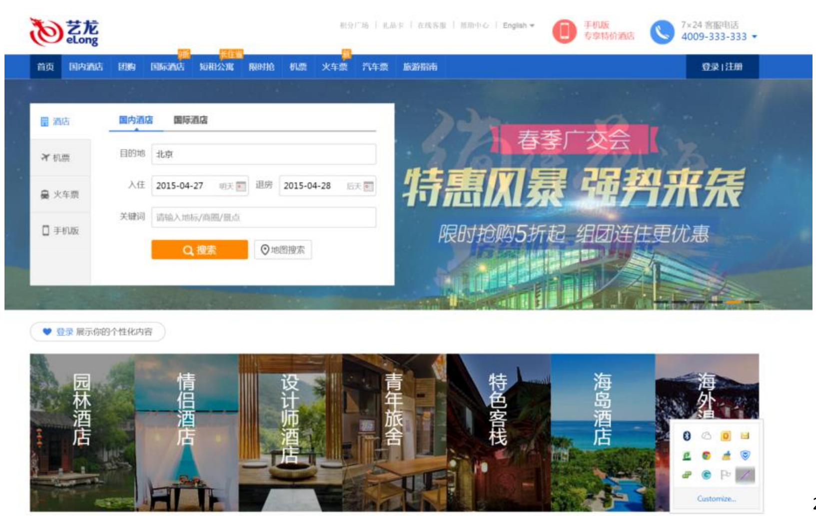
- **The growth of China travel market**: China's transformation to a consumption driven economy will create a large middle class population with more spending power, and a higher degree of willingness to travel, benefiting the China travel/transportation/hotel industries.
- **Increasing market share**: China's online travel industry will continue to grab market share from traditional offline business with the rise of the overall PC/mobile penetration rate in China and the involvement of BAT (three internet giants in China: Baidu, Tencent & Alibaba).
- **Heavy competition may bring negative impact, but benefit the industry in the long term**: We have seen an industry wide convergence of business models. Large OTAs have started to explore marketplace business models and current leader Qunar has in turn launched its direct sales business. These convergences have resulted in heavier competition in the industry, consequently industry leaders are emphasizing volume increases over profits. We believe this trend will continue into 2015 and cause negative financial impact in the short term. We also believe increasing competition will drive a faster rate of adoption to online travel bookings. After the industry consolidation phase, **winners in this industry will enjoy tremendous network effect with increasing bargaining power over suppliers.**
- **Online travel players sit at the center of the travel supply chain,** both OTA (eg. Ctrip) and marketplace (eg. Qunar) models bring upstream suppliers and consumers to a single platform and monetize on transactions. However, OTA carries "inventory" from hotels and airlines while marketplace model brings airlines, hotels, other ticket vendors and travel agents to its P4P (pay for performance) platform.



Online travel value chain, based on the framework from iResearch

CTRP vs LONG's Economic Moat

A good business should have attractive economic moats in order to sustain its competitive advange over the long run. A company with a long term competitive advantage enjoy both **price premium and cost efficiency**. In our previous analysis on Ctrip, we believe Ctrip has a strong economic moat, both on price premium (network effect) and cost efficiency (low incremental cost of platform business). However, compared to Ctrip, eLong lacks these key characteristics to be a viable online travel platform.



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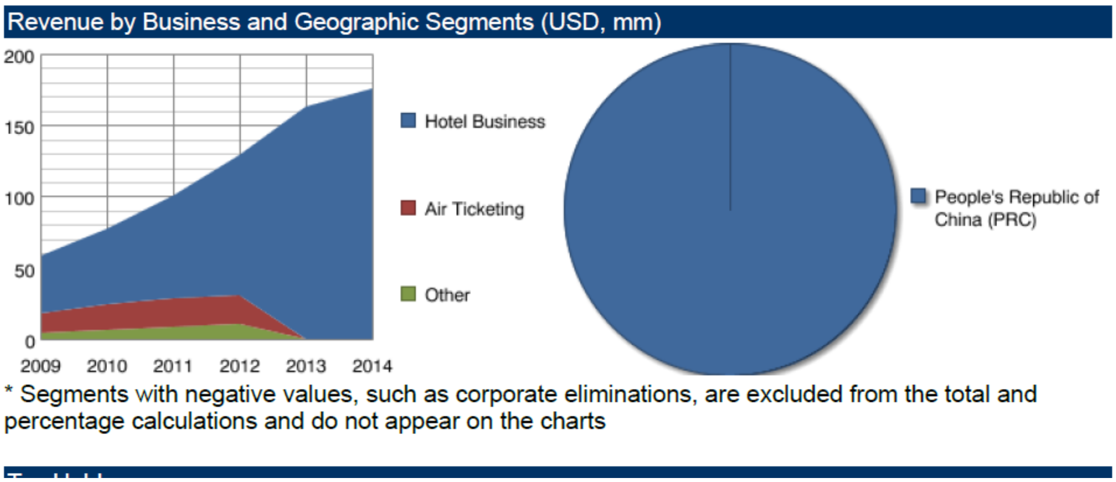
[2] Elong.com

Network effect and eco-system

In the online travel agent space, the user network is extremely important given that the value of the platform is strongly dependent on the number of consumers using it. Ctrip has built a sustainable competitive advantage with its **one-stop travel shop (air-tickets, hotels and vacation packages)** platform strategy and vast user generated content (UGC). On ther other hand, eLong's strategy has been focused primarily on hotel booking in the early years. This strategy once helped eLong beome one of the market leader in the space. However, Chinese internet users are shifting towards more comprehensive travel platforms (Ctrip and Qunar), because they can access services which fit their travel needs.

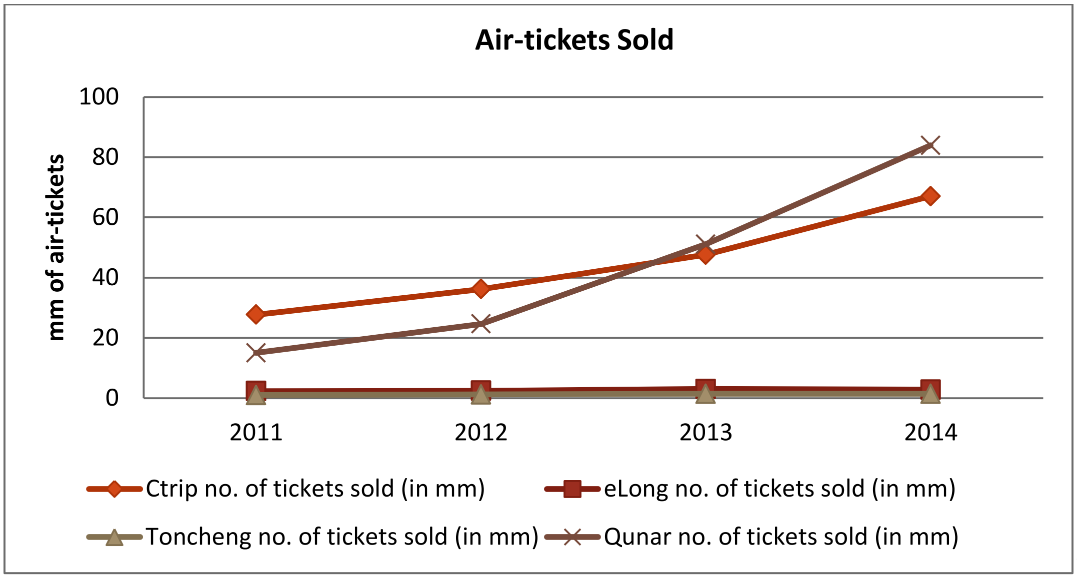


[3]

In addition, eLong's hotel inventory faces heavy pressure from Ctrip. Ctrip is increasing its hotel coupon offerings to attract more user traffic. With more user traffic, Ctrip platform becomes a preferred partner for hotels. Ctrip exploits this bargaining power, which shifts and forces hotel chains to enter exclusive agreement with Ctrip. However, lagging Ctrip in both user traffic and cost efficiency, eLong cannot do much other than lose inventory suppliers to Ctrip.

eLong has also realized this problem of being too narrowly focused on hotel booking and the company tried to shift gears to expand their air ticketing and vacation package offers. Unfortunately, Qunar and Ctrip have already built a huge presence on air ticket booking and we don't think along has the capital and resource to inverse the chain.

[3] WikiInvest



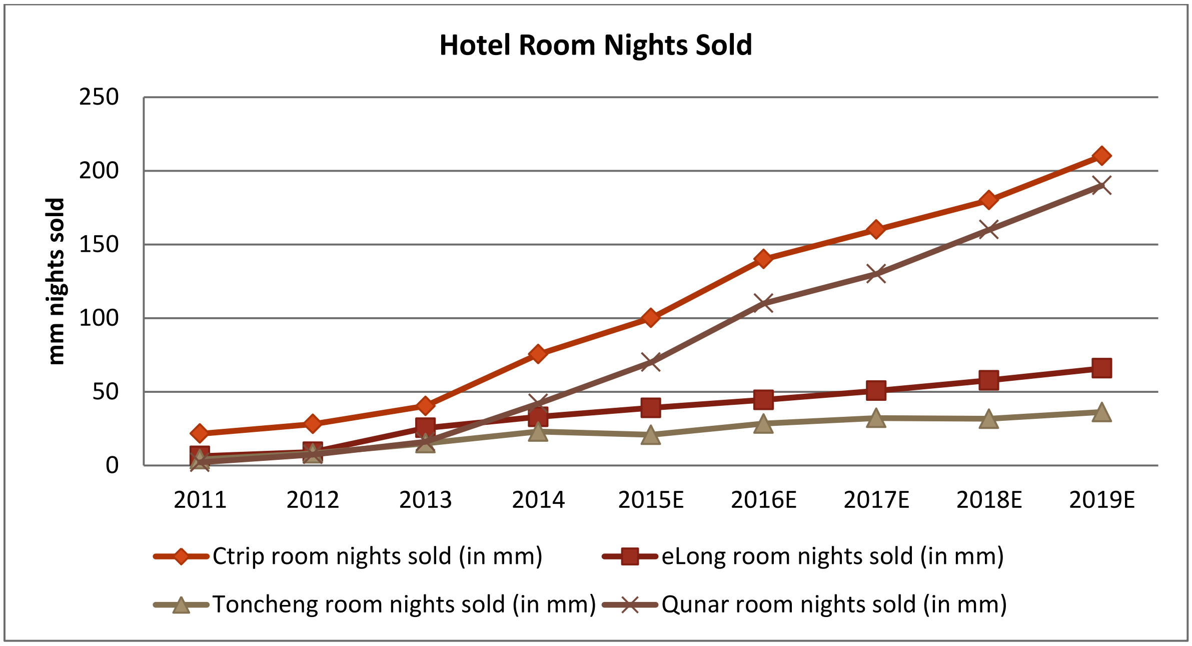
[4]

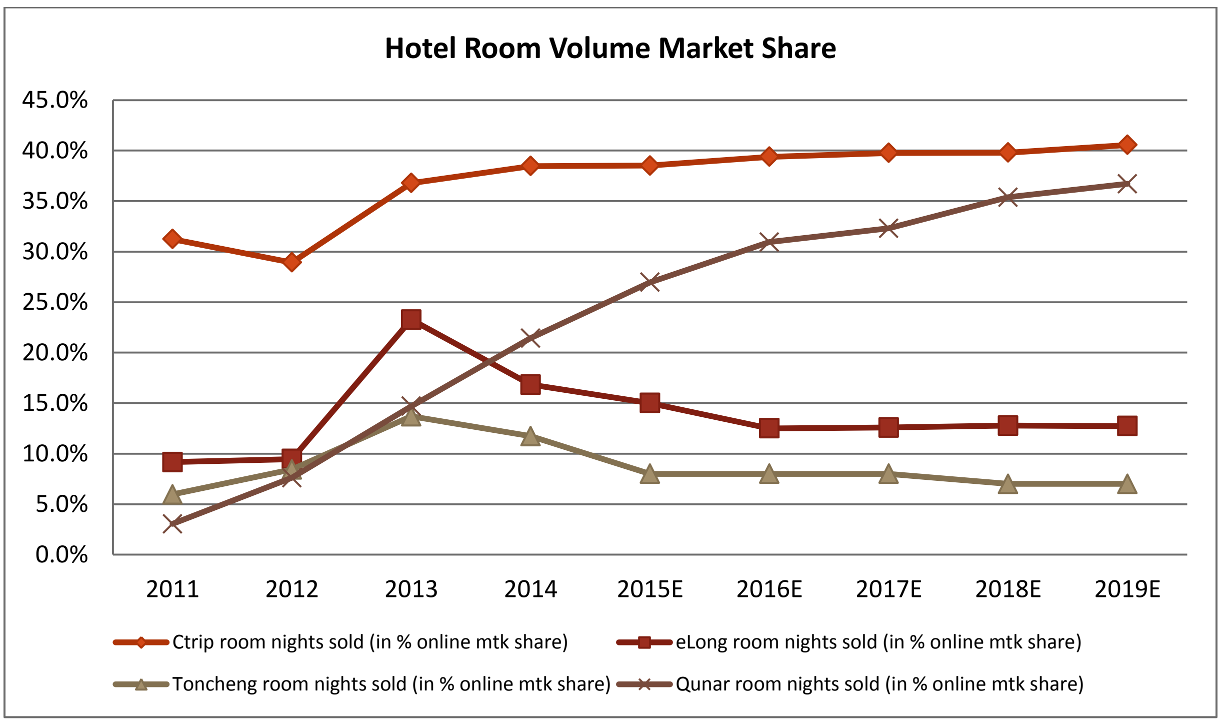
As we mentioned in our previous reports, vacation package sales have been a new growth engine in the online travel space. Not only exciting giants are taking steps to grab market shares, but also emerging dedicated vacation package sales websites (eg. Tuniu) are making a run in this sector. eLong has been investing heavily in the vacation package space and hope this can be a new growth driver for the company. We don't see any viability in this space because it is still in early stage, but we do believe vacation package market is an ecosystem play. The winners in the market not only need to have strong inventories in both transportation and accommodation. It also needs to have good relationships with travel agents and have capital to make investments in emerging UTC players.

In 2014, Ctrip made investments in rivals LY.com and Tuniu. The US$200m investment in LY.com and US$15m investment in Tuniu, both focused on vacation and tourism packages in China, signaled that the Chinese online travel market may be finally headed towards consolidation. With over US$1bn in cash on its balance sheet, Ctrip can be an active player in this consolidation phase, receiving the double benefit of simultaneously eliminating competition and expanding its ecosystem. On the other hand, eLong has neither strong inventory nor free capital to invest (most of their capital will be tied to expanding their hotel booking business), therefore we do not believe eLong can be a serious competitor in the vacation package space.

In summary, we believe eLong will gain hotel booking market share at a much slower rate than both Ctrip and Qunar. Because of their inability to achieve operating leverage, eLong is not likely to survive in this competitive industry.

[4] Company data and TravelSky





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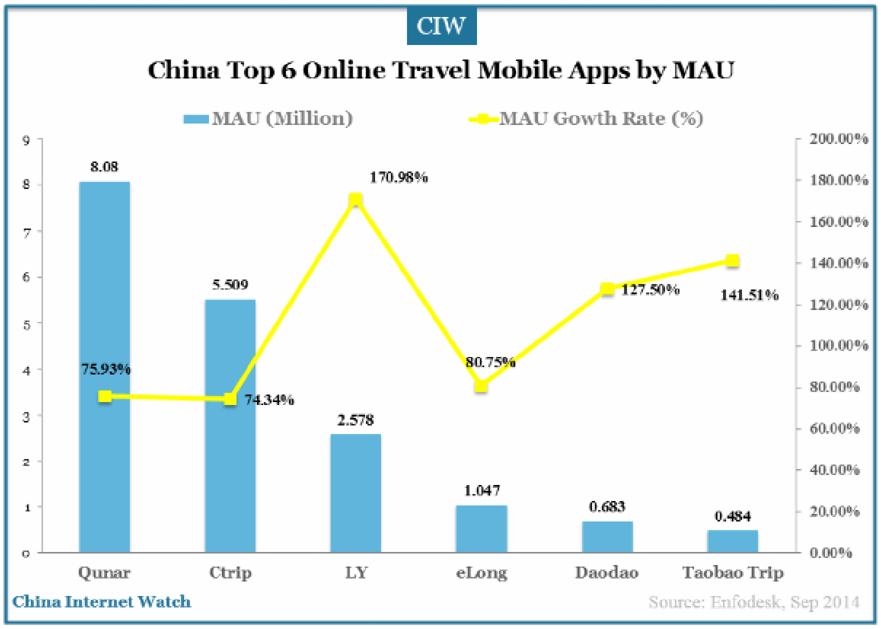
Losing the mobile battle

As with most other online markets, the industry is trending toward mobile platforms. Mobile penetration is a very important metric in this online travel "tug of war". Users are spending more time on mobile and being able to engage in travel booking while out of office/home.

[5] Company Data and TravelSky

Currently eLong is lagging its competitor significantly, with only a little over 1 million MAU, even behind the upcoming non-public OTA site LY. For eLong's largest competitor Ctrip, it now has 600m registered and 200m active mobile users. In 4Q15, Ctrip mobile accounted for 70% of hotel reservations versus 40% in 1Q, 55% of air ticket transactions versus 30% in 1Q, and over 40% of new customers are from mobile, highlighting the importance of this segment. Both eLong and Ctrip are behind market leader Qunar, which has a marketplace business model (similar to Kayak) versus OTA model (Priceline, Expedia). Given Ctrip's overall market leading position, it should be able to overtake Qunar's position as it continues to shift its large user base to mobile.

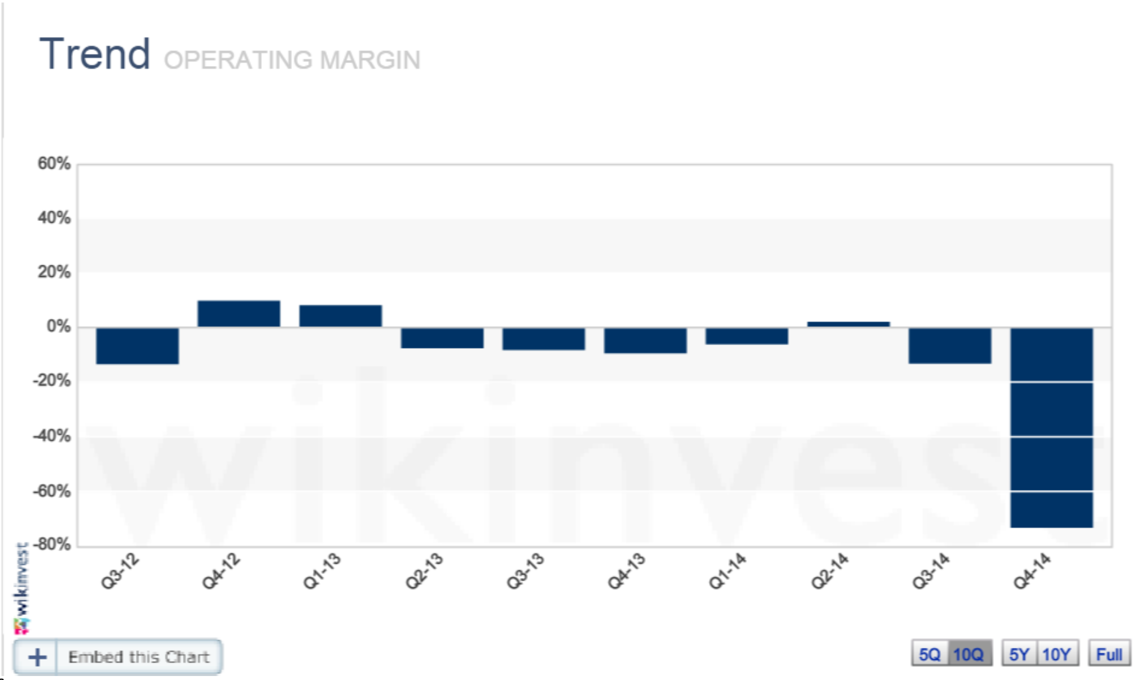


Scalable platforms and operating leverage

In theory, as a platform business, eLong should enjoy the benefit of **both economies of scale and scalable products/services**. eLong has a "visual inventory" because of its business nature, therefore it has no physical plant, which gives eLong a relatively light capital structure. As it brings on more suppliers or increase volume, it may get more discounts from supplier, therefore enhancing its return on incremental capital.

Questions arise since we do not see any kind of operating leverage from the company. In fact, operating margin went in the opposite way. We believe this margin decline is due to the platform model cost efficiency failure: 1. Lost of pricing control to industry leaders, which leads to higher marketing expenses; 2. Losing traffic and inventory to industry leaders, which makes it difficult to achieve operating margin.

We expect both S&M and R&D to go down as a percentage of revenues as the industry wraps up its investment cycles and restores its pricing disciplines.



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Risk Considerations

The key risk considerations are:

- **Strategic investors and M&A risks:** eLong's largest shareholders are Expedia, Inc. (Nasdaq: EXPE) and Tencent Holdings Ltd. (HKSE: 0700). eLong may benefit from a new round of capital injections or traffic redirections from these deep pocket giants. However, eLong has so far failed to take advantage of its relationship with Expedia as it currently has no international presence. Compared to Ctrip and Priceline, eLong has failed to leverage its partner's network.

  eLong currently has a market cap of only $600mm, which also makes it a potential target for acquisition for industry leaders.

Top Holders

Holder	Common Stock Equivalent Held	% of Total Shares Outstanding	Market Value (USD in mm)
Expedia Inc.	22,920,823	63.67	373.6
Tencent Holdings Ltd., Investment Arm	5,535,000	15.37	90.2
Auriana, Lawrence E.	1,455,555	4.04	23.7
PAR Capital Management, Inc.	864,214	2.40	14.1
Purple Mountain Holding Ltd.	766,840	2.13	12.5

Holders as of Monday, April 20, 2015

[7]

[6] WikiInvest

Valuation and Assumptions

Air Ticketing services

Customers can book air ticketing services through eLong's toll-free customer service center, mobile applications and websites. eLongacts as an agent for major airlines in China as well as international airlines that operate flights originating in China. It then receives a commission when an airline ticket is sold, and certain airlines also provide discretionary commissions if eLongachieves performance targets.

Key assumptions:

- **Air ticket sold market share:** is based on the assumption that eLongwill maintain its current market share of 0.8%. The company has experienced sluggish volume growth and falling commission rates, so we do not expect it to gain any market share against existing competitors.
- **Commission rate**: starting in 2015, we expect commission rate to fall by 1% to 3.75%, as management indicated many airlines have cut base commission rates by 1%.
- **Average ticket price:** since eLongonly sells domestically, we project average ticket prices at the industry average rate.
- **Overall air ticket revenue:** for 2015, we expect air ticket revenues to fall by 7.4% as a result of slow volume growth and the aforementioned fall in commission rates. Then growth will stabilize at a 8.6% annual growth rate to maintain its 0.8% market share.

Hotel reservations

This is eLong's largest business segment by revenue. eLongoffers a broad range of hotels with a variety of booking models, price points and payment choices for its customers, including budget, three-, four- and five-star hotels, short-stay apartments, and groupbuy hotels. The company acts primarily as an agent in hotel transactions, including agency bookings in which the customer books with eLongand then pays the hotel at the time of check out as well as merchant bookings in which the customer pays eLongand then we pay the hotel. Hotel commissions are generally a percentage of the nightly hotel room rate or a fixed amount per room night.

Depending on the agreement with the hotel supplier, eLongeither receives a guaranteed allotment of hotel room nights per month or operate on an "as-requested" or "free sale" basis. For hotels with which eLonghas room allotments, the hotel makes available a specified number of guaranteed available rooms each day. A room allotment allows eLongto provide customers with instant confirmation of their reservations.

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[7] Capital IQ

eLongis currently the number two player in China based on hotel reservation revenue, behind only Ctrip. It is the number three player based on hotel room volume, behind Ctripand Qunar.

Key assumptions:

- **Hotel room sold market share:** we project eLongto ultimately hold 10% of the online hotel market by 2019 from its current 6.7% market share, behind market leaders Ctrip (projected 33% market share) and Qunar (projected 25% market share). We believe this to be the case as a result of industrywide consolidation and only a handful of firms with meaningful market share will remain.
- **Hotel volume growth:** is expected to grow by 15% annually from 2015-2019 to reach the projected market share of 10%.
- **Commission rate per room**: has fallen each of the past three years due to intense competition. We expect it to fall further in 2015 as management concedes that competition will continue to squeeze prices, and then we project it to stabilize at 7% from 2016 on.
- **Average room price:** since eLongdoes not offer any international hotel rooms, so we project average price to be the domestic industry price.
- **Overall hotel room revenue:** for 2015, we expect hotel room revenue growth to pick up as management continues to focus on gaining market share and expanding its network. Starting in 2016, we expect revenue growth to further increase as price levels stabilize and the industry consolidates, with eLongtaking in 10.4% market share. From 2015-2019, the hotel segment is projected to grow at a 14.5% CAGR.

Other

Other revenues consist of advertising revenues on the eLong and Xici websites and the sale of travel insurance.

Key assumptions:

- This segment has been growing at approximately 9%. We expect this trend to continue and assume it will continue at the current pace. This assumption is reasonable given the hotel reservation segment is growing at a projected 14.5% CAGR and related advertising and insurance should expand along with it.

Business segment projections

- **2015 revenues**: based on the above factors, 2015 revenue is expected to increase by 9.6% and then approximately 14% annually until 2019. The boost in subsequent growth is driven predominately by the hotel segment, which we believe will experience stabilizing prices as the fierce competition nears a bottom.

- **2019 revenues**: our 2019 revenues represent a 5-year CAGR of 13.1%, which is slower than our projected 22% CAGR of the entire online travel market[8]. This is a result of slow air ticketing growth, average hotel room sales growth, and a lack of other faster growth drivers such as vacation packages and international travel options.

Key Assumptions & Metrics	2015	2016	2017	2018	2019
Revenue growth rate	**9.6%**	**14.4%**	**14.4%**	**14.3%**	**13.1%**
Air ticket market share	0.8%	0.8%	0.8%	0.8%	0.8%
Air ticket revenue growth rate	*(7.4%)*	*9.9%*	*8.8%*	*8.2%*	*7.6%*
Hotel reservations market share	7.5%	8.1%	8.8%	9.6%	10.4%
Hotel reservations revenue growth rate	*11.9%*	*15.5%*	*15.5%*	*15.4%*	*14.0%*
Other services growth rate	*9.0%*	*9.0%*	*9.0%*	*9.0%*	*9.0%*
Gross margin	65.0%	65.0%	65.0%	65.0%	65.0%
Service development (as a % of sales)	25.3%	23.3%	21.3%	19.3%	17.3%
S&M expenses (as a % of sales)	55.0%	50.0%	45.0%	40.0%	35.0%
G&A expenses (as a % of sales)	13.6%	13.6%	13.6%	13.6%	13.6%
Operating margin	(29.7%)	(22.5%)	(15.4%)	(8.3%)	(1.2%)
Effective tax rate	25.0%	25.0%	25.0%	25.0%	25.0%
Earnings Per Share Diluted	**-¥1.63**	**-¥1.37**	**-¥1.01**	**-¥0.55**	**¥0.06**
Earnings Per Share Diluted in $	**-$0.27**	**-$0.23**	**-$0.17**	**-$0.09**	**$0.01**

Valuation

Our DCF yields a result of $4.10 based on a discount rate of 10.6% and a terminal growth rate of 4%. The calculated price is 76% below current price of $16.82.

Key inputs:

- **Beta:** we ran a linear regression test to obtain eLong's beta of 0.93 by using (2/3)*calculated bete + 1/3.
- **Gross margins:** we expect gross margins to continue to fall in 2015 as price competition and the eCoupon program continues to erode profitability in the hotel segment. We do expect margins to stabilize at 65% as the competition reaches a bottom.
- **Service development and selling and marketing costs:** relate to costs related to development and maintenance of transaction and service platforms, and online and offline advertising costs. Management expects these costs to continue to grow but the rate of growth should slow. We have built in the expectation that these costs will stabilitze and grow at a slower rate than revenue as the company gains economies of scale on its platforms and advertising efforts. Hence we have incorporated a negative step of -2.0% and -5.0% for service development, and selling and marketing costs, respectively. These percentages are consistent with our analysis of Ctrip and do not cause a material change in our valuations, hence we believe the -2.0% and -5.0% are reasonable.

[8] Refer to our China Online Travel Industry Report

Sales		744.25	1,009.73	1,086.18	1,190.09	1,361.66	1,557.12	1,780.44	2,014.15
Earnings		0.49	(167.66)	(268.99)	(238.41)	(205.80)	(155.25)	(86.00)	9.75
CFO					(174.83)	12.00	76.06	158.91	258.90
EBITDA		(38.15)	(140.97)	(260.35)	(299.04)	(240.99)	(166.59)	(65.85)	66.50
EBIT		(66.14)	(178.11)	(310.40)	(353.05)	(306.48)	(239.56)	(147.56)	(24.47)
Less: Taxes @	25.0%	16.0	(59.5)	(13.1)	79.8	68.9	52.4	29.3	(1.9)
Tax-effected EBIT		(50.1)	(237.6)	(323.5)	(273.2)	(237.5)	(187.1)	(118.2)	(26.4)
Plus: Depreciation		26.9	33.2	41.4	45.3	57.7	66.0	75.4	85.3
Plus: Amortization		1.1	4.0	8.7	8.7	7.8	7.0	6.3	5.6
Plus: SBC		0.0	0.0	97.7	95.1	95.2	93.3	88.9	80.5
Less: Capital expenditures		(52.7)	(47.1)	(58.6)	(64.2)	(81.7)	(93.4)	(106.8)	(120.8)
Less: Additions to definite life intangibles		(14.7)	(1.7)	(68.4)	0.0	0.0	0.0	0.0	0.0
+ / - Changes in long-term investments		(42.0)	(10.0)	(44.9)	(45.0)	(45.0)	(45.0)	(45.0)	(45.0)
+ / - Changes in working capital		0.0	71.9	258.6	(64.3)	57.1	65.1	74.4	77.8
+ / - Changes in other assets and liabilities		0.0	20.9	29.8	(21.2)	(0.1)	(0.1)	(0.1)	(0.1)
Unlevered Free Cash Flow		**(131.60)**	**(166.36)**	**(59.17)**	**(318.84)**	**(146.46)**	**(94.25)**	**(25.15)**	**56.92**
Unlevered Free Cash Flow Growth Rate						*(54.1%)*	*(35.6%)*	*(73.3%)*	*(326.3%)*

Beta	0.93
Equity Risk Premium	6.02%
China Risk Remium	3.0%
Risk free rate	2.2%
Discount Rate	10.6%

Perpetuity Growth Method			**P/E Multiple Method**		
		10.6%	**Weighted average cost of capital:**		**10.6%**
Net present value of free cash flow (b)	¥	-460.22	Net present value of free cash flow (b)	¥	-460.22
Growth rate of FCF after 2019		4.0%	**Exit multiple**		30.0x
Terminal value	¥	899.87	**Terminal value**	¥	292.48
Present value of the terminal value (c)	¥	544.30	Present value of the terminal value (c)	¥	176.91
Long-term investments	$	15.76	Long-term investments	$	15.76
Mutiplier		1.00	Mutiplier		1.00
Enterprise Value	**$**	**29.43**	**Enterprise Value**	**$**	**(30.30)**
LESS: Net Debt (d) (e)		266.3	LESS: Net Debt (d) (e)		266.3
Equity Value	**$**	**295.77**	**Equity Value**	**$**	**236.03**
Diluted shares:		72.009	Diluted shares:		72.009
Equity Value Per Share (f)	**$**	**4.11**	**Equity Value Per Share (e)**	**$**	**3.28**

17.04

0.758953299

Implied EBITDA Exit Multiple		**Implied Perpetuity Growth Rate**	
Terminal year unlevered free cash flow	$56.9	Terminal year FCF	$9.7
Weighted average cost of capital	10.6%	Weighted average cost of capital	10.6%
Growth rate of free cash flow after 2019	4.0%	Multiple	30.0x
2019 EBITDA	$66.5	Terminal year unlevered free cash flow	$56.9
Implied EBITDA Exit Multiple:	**13.5x**	**Implied Growth Rate:**	**(7.4%)**
($56.9 x (1+4.0%)) / ($66.5 x (10.6% - 4.0%)) = 13.5x		*($9.7 x 30.0 x 10.6%) - $56.9) / ($56.9 + ($9.7 x 30.0)) = -7.4%*	

Trading at $16.82 as of 4/27/2015

Valuation Intuition

We want to get a sense of how the market is justifying its current valuation of eLong, and assess what needs to happen for our thesis to be wrong. Therefore, we looked at market scenarios that would break cripple our short thesis.

Key considerations:

- Our current valuation assumes a constant 0.8% market share in air ticketing, and an expanding market share in hotel rooms sold reaching 10.4% in 2019.
- Based on our model, if we assumed a 3.0% market share in the air ticketing space (40% implied CAGR), and a 20% market share in hotel segment by 2019 (30% implied CAGR), share price would be $9.53, which is still a -43% return based on current price of $16.82.
- In fact, for eLongto justify its current valuation, eLonghas to reach 3.0% market share in air ticketing from current market share of 0.8%; 40% CAGR from 2015-2019) and 32.4% in hotels (from current market share of 7%; 43% CAGR from 2015-2019).
    - Air ticketing segment: 3.0% market share is extremely difficult to achieve since it requires eLongto grow its air ticketing revenue at a faster rate than it has in the past three years, while competing against the likes of Ctripand Qunar, who have a dominant position in this segment

- Hoteling segment: 32.4% market share by 2019 is on par with our forecast for Ctrip. For this to happen, eLonghas to surpass Qunar, which we project will have a 25% market share by 2019. We find this highly unlikely since Qunarhas grown at a faster rate in both the web and mobile platforms, and given its marketplace advantage, it should continue to grow at a rapid (see our Qunarreport for details). We also do not believe eLongwill catch up to Ctripgiven Ctrip's current position as the dominant player in the hotel space, and is the only OTA player that is making money. With these advantages, Ctripshould continue to leverage its market leader position and solidy its hold over this segment. Finally, with both Ctripand Qunar also focusing on international bookings, which eLonghas no presence in, we do not see eLongovertaking those two players.

	Historical Year Ending December 31,			Projected Year Ending December 31,				
	2012	2013	2014	2015	2016	2017	2018	2019
LONG air-ticket sold	2.40	3.00	3.30	13.20	14.42	15.60	16.79	17.96
% yoy growth		25.0%	10.0%	300.0%	9.3%	8.2%	7.6%	7.0%
Market share %	*0.7%*	*0.8%*	*0.8%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
Commissions per air ticket	**51.56**	**45.00**	**38.00**	**33.00**	**33.19**	**33.38**	**33.56**	**33.75**
Change in commissions per ticket		*-12.7%*	*-15.5%*	*-13.2%*	*0.6%*	*0.6%*	*0.6%*	*0.6%*
Commission rate	**4.60%**	**4.09%**	**4.32%**	**3.75%**	**3.75%**	**3.75%**	**3.75%**	**3.75%**
LONG hotel nights sold	16.10	25.80	34.20	48.91	69.94	100.01	143.01	204.51
% yoy growth		*60.2%*	*32.6%*	*43.0%*	*43.0%*	*43.0%*	*43.0%*	*43.0%*
Market share %	*3.7%*	*5.6%*	*7.0%*	*9.4%*	*12.8%*	*17.4%*	*23.7%*	*32.4%*
Commissions per hotel night	**37.78**	**33.26**	**27.45**	**26.95**	**27.30**	**27.65**	**28.00**	**28.00**
Change in commissions per hotel night		*-12.0%*	*-17.5%*	*-1.8%*	*1.3%*	*1.3%*	*1.3%*	*0.0%*
Commission rate	**9.2%**	**7.5%**	**7.2%**	**7.0%**	**7.0%**	**7.0%**	**7.0%**	**7.0%**

Beta	0.93
Equity Risk Premium	6.02%
China Risk Remium	3.0%
Risk free rate	2.2%
Discount Rate	**10.6%**

Weighted average cost of capital:		**10.6%**
Net present value of free cash flow (b)	¥	222.35
Growth rate of FCF after 2019		4.0%
Terminal value	¥	9,303.54
Present value of the terminal value (c)	¥	5,627.37
Long-term investments	$	15.76
Mutiplier		1.00
Enterprise Value	**$**	**966.94**
LESS: Net Debt (d) (e)		266.3
Equity Value	**$**	**1,233.28**
Diluted shares:		73.098
Equity Value Per Share (f)	**$**	**16.87**

Important Disclaimer