

Qunar Cayman Islands Ltd. (QUNR)



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Executive Summary



Qunar Cayman Islands Limited is a search-based commerce platform for the travel industry in China. The Company's customers

include travel service providers (TSPs) and display advertisers. The Company's platform is designed to facilitate and enhance convenience, data accuracy, and transaction security for its users. The Company provides products and services for its users to search for travel products and promotions, plan itineraries and complete their travel purchases.

Qunar has **3** main revenue drivers: **pay-for-performance (P4P)**, **display advertising services**, and **other services**. Among them, P4P accounts for over 95% of company revenues. The main drivers of the P4P segment are the air ticket business, hotel business, vacation packages, and train tickets.

Our thesis is that while Qunar has several factors that will continue to drive strong future growth, including its shift into the OTA market, the synergy from this shift, and mobile penetration, there are also significant risks that will pressure share prices, including intense competition, lack of competitive advantage, and current rich valuations. The stock has performed well in the past 12-months, up over 50%, and close to 100% over the past 6 months. Current price is close to our price target of **\$44.87 for the stock, which represents a 6.67% downside**. Because of the small expected returns, we recommend a hold rating.



Source: Reuters

TICKER: **QUNR**

RATING: **HOLD**

TARGET PRICE: **\$44.87**

POTENTIAL UPSIDE: **-6.67%**

Contents

Executive Summary.....1

Industry Trend Recap1

QUNAR’s Evolving Business Model2

Synergy of Marketplace and OTA4

Mobile Penetration5

Risk Considerations.....6

Valuation and Assumptions.....8

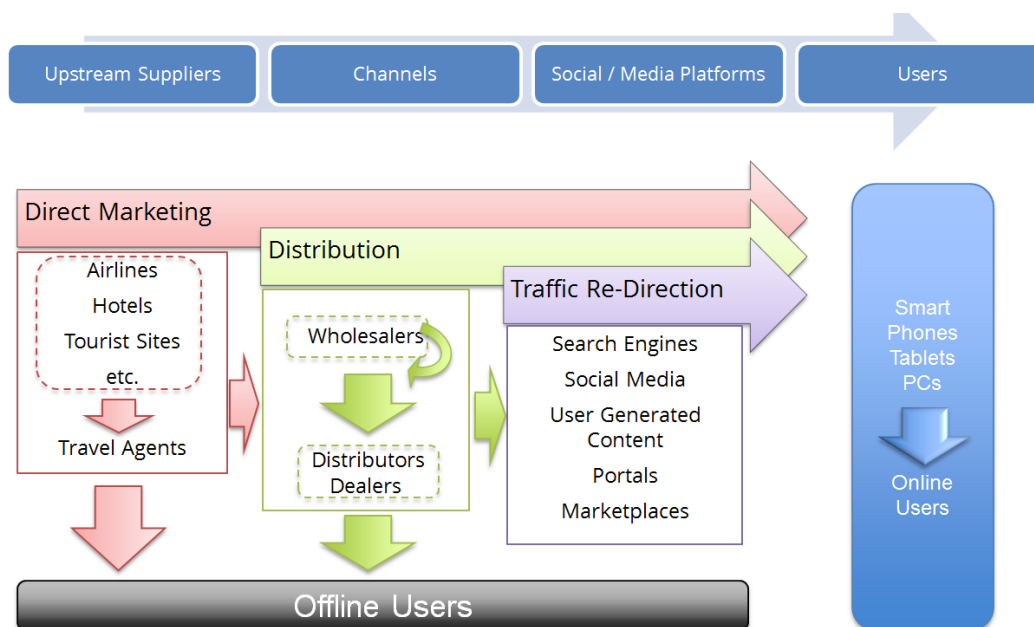
Business segment projections.....8

Important Disclaimer16

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 a negative financial impact in the short term. We also believe increasing competition will drive a faster rate of adoption for online travel bookings. After the industry consolidation phase, **the winners in this industry will enjoy a 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. As we will discuss in detail below, Qunar is making the moving to become a hybrid of marketplace and OTA.

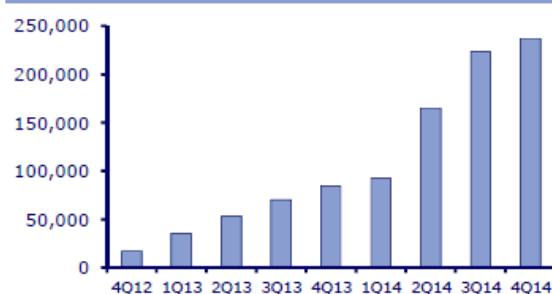


Online travel value chain, based on the framework from iResearch

QUNAR's Evolving Business Model

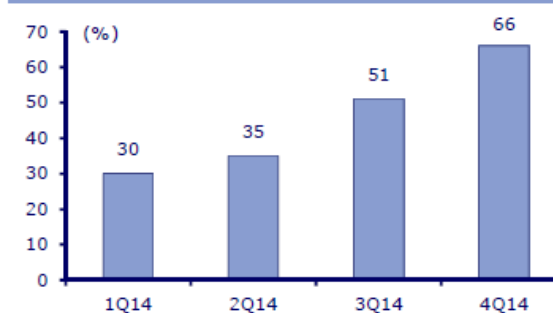
Qunar is currently the fastest growing player in the Chinese online travel space. The main reason behind this is the company's move from a pure marketplace to a marketplace and OTA. In 4Q14, Qunar has significantly expanded its presence in the direct sale hotel market, and for the first time has more direct sales than platform sales in terms of volume at 66%. Management is optimistic that hotel direct sales will account for over 80% of total hotel volume in the long run. The company has also expanded its work force from 2,500 to 7,500 employees during 2014¹. This signals that Qunar is committed to becoming an OTA in the hotel booking segment and directly challenging Ctrip and eLong.

Number of hotels under direct sales



Source: CLSA

Direct sales volume/total volume



Source: CLSA

¹ Barclays Equity Research Report

In hotels, Qunar is also trying to move up the value chain and target more lucrative hotels. In 4Q14, four/five-stars hotels contributed 30% of total hotel revenues². However, QUNR is still working off of a small base in comparison to the more established OTA players.

In December 2014, Qunar also launched its English website Qua. This is the right move to try to capture the more lucrative international market for both flights and hotels. However, compared to Ctrip, which has a partnership with Priceline, and eLong, which is majority owned by Expedia, Qunar may lack the network to compete effectively in the international market, and it has also had a much later start. While this may appear to be a great growth opportunity, there is no compelling reasons to justify how Qunar could take market share in the international segment versus the aforementioned competitors.

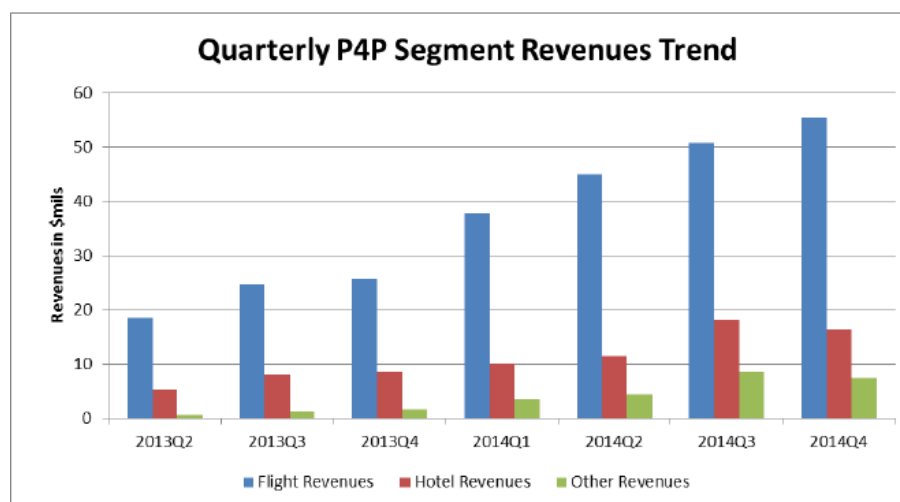


Source: Company website

² Company 20-F

Synergy of Marketplace and OTA

Since 2005, Qunar has concentrated on building the largest searched-based marketplace connecting TSPs and travelers. Beginning in 2013, the Company made a strong push into the OTA market, which has been dominated by Ctrip (CTRP) and eLong (LONG). Since that time, Qunar's P4P revenue has taken off, especially in the air ticket segment, which has nearly tripled in revenue since 1Q13. In a short span, the Company has been able to expand its direct sales alliances to over 237,000 hotels worldwide in 4Q14, versus 223,000 in 3Q14, and only 92,000 in 1Q14³.



Source: Company documents

This staggering growth was possible due to its vast marketplace platform and subsequent easy access to airlines and hotels, and Qunar will continue to leverage off its marketplace advantage.

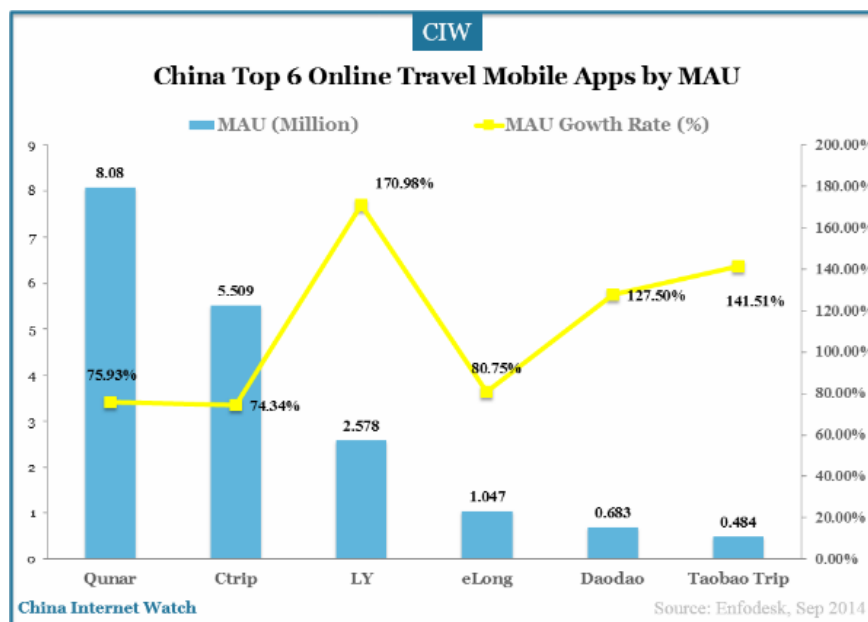
QUNR's vast marketplace also gives it an advantage in data analytics. In 2014, the Company was able to identify important user behaviors on mobile, including users spend longer time on QUNR mobile platform versus PC platform, and the more mature the cohort, the more frequently they visit the platform. This had a direct impact on Qunar's mobile strategy and marketing initiatives, which resulted in spectacular results for its mobile penetration (detailed below).

QUNR may face some challenges going forward given the interesting dynamic that will result from promoting other TSPs and promoting its own direct sales offerings, which may hurt its marketplace status going forward.

³ Company 20-F

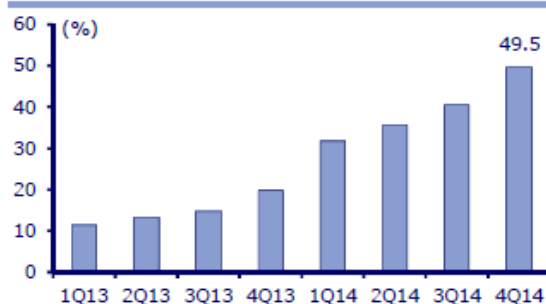
Mobile Penetration

As with most other online markets, the industry is trending toward mobile platforms. Mobile penetration is a very important metric in this online travel battlefield. Users are spending more time on mobile and being able to engage in travel booking while out of office/home fills users' travel needs. Qunar has rapidly expanded its mobile presence. Mobile accounted for 49.5% of overall revenue in 4Q14, up from 40.4% in 3Q14. More specifically, it accounted for 46% of flight volume and 70% of hotel volume, compared to 43% and 55% in 3Q, respectively.

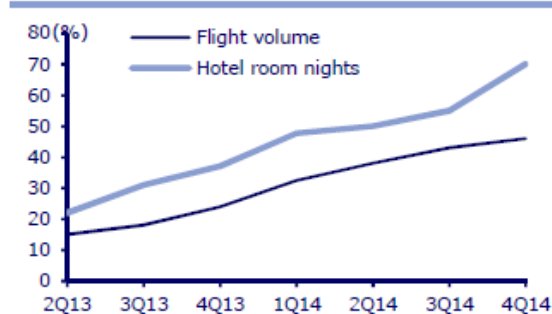


Combined with its established marketplace presence, QUNR is currently the market leader in mobile monthly active users.

Mobile as % of total



Mobile contribution to volume



Source: Company data, CLSA

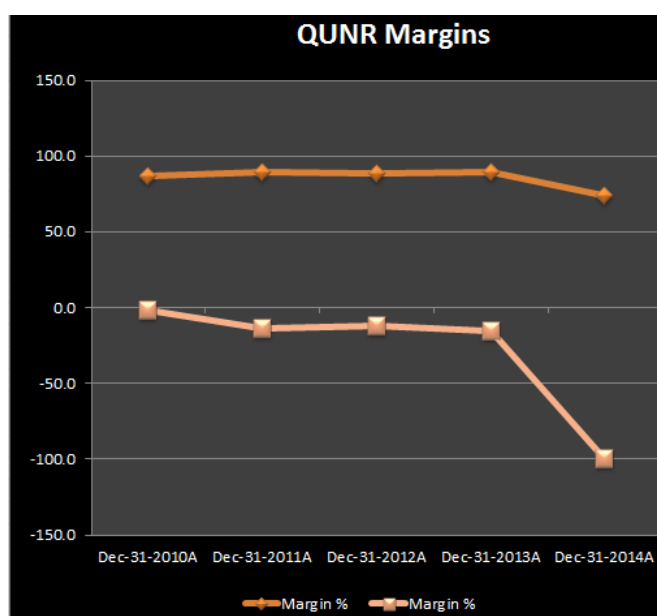
A side benefit of the shift to mobile is the impact on Qunar's cost structure. Under the Baidu Zhixin Agreement, Qunar has the exclusive right to operate the their shared platform for flights, hotels, and packaged products. As a result, Baidu will deliver over 2.2 billion page views each

year⁴. The cost was approximately \$150 million per year. However, with less emphasis on PC, total spending on Zhixin is expected to decrease to between \$30-40 million, which will help Qunarto trim expenses and narrow losses.

Risk Considerations

The key risk considerations are:

- Intensify competition:** The online travel market in China is still marred by strong competition. Every player in the market has seen its profit margins hurt by price competition. Competitors such as Ctrip, the OTA market leader, has launched coupon program to essentially subsidize customers for hotel bookings. Now that Qunar has declared itself as a direct competitor of existing OTA players, price and channel wars should intensify further and margins may continue to feel the squeeze. Gross margins began to decline in 2013 when Qunar decided to enter the OTA space. But EBITDA margins really collapsed as it began to engage in price wars with existing OTA players, and has reached an unsustainable -100% in 2014. For Qunarto to survive and continue, it needs to find a better way to compete and cannot sustain the status quo.



Source: Company data

- Too far behind the leader:** Ctrip is currently the market leader in the OTA market. It has close to 56%⁵ of the market share based on revenue as at 3Q2014, and is currently defending its position with aggressive coupon programs. Even with the exceptional growth

⁴ Barclays Equity Research Report

⁵ iResearch, October 2014

that QUNR has experienced in the past two years, it is still far behind Ctrip, especially in hotel sales.

	Air tickets revs (US\$mn)					Air tickets revs yoy growth					Air tickets sold yoy growth				
	4Q13	1Q14	2Q14	3Q14	4Q14E	4Q13	1Q14	2Q14	3Q14	4Q14E	4Q13	1Q14*	2Q14*	3Q14*	4Q14*
Ctrip	95.6	104.7	117.0	130.3	124.5	29%	43%	39%	32%	32%	37%	71%	83%	98%	NA
Elong	5.4	5.7	5.7	4.3	4.5	3%	12%	-1%	-24%	-13%	30%	8%	4%	-4%	23%
Qunar	26.3	37.9	45.0	50.8	55.5	78%	90%	143%	104%	116%	94%	75%	66%	57%	62%

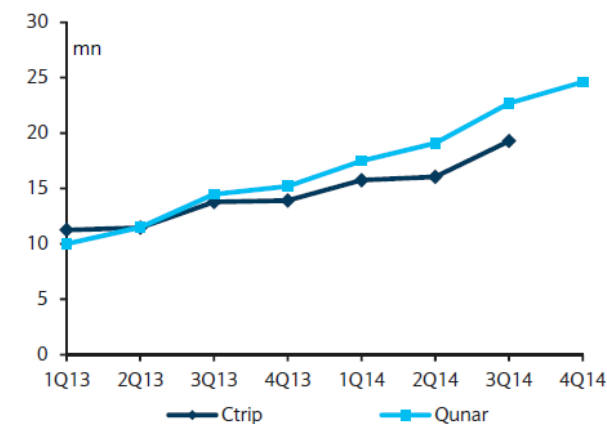
	Hotel reservation revs (US\$mn)					Hotel reservation revs yoy growth					Room night sold yoy growth				
	4Q13	1Q14	2Q14	3Q14	4Q14	4Q13	1Q14	2Q14	3Q14	4Q14	4Q13	1Q14*	2Q14*	3Q14*	4Q14*
Ctrip	106.1	105.6	121.3	154.8	139.4	37%	46%	47%	56%	33%	55%	67%	64%	69%	NA
Elong	37.1	33.0	41.0	44.0	33.9	28%	14%	28%	6%	-6%	48%	43%	44%	22%	27%
Qunar	8.8	9.9	11.5	18.2	16.5	84%	55%	80%	98%	77%	99%	101%	105%	85%	108%

Source: Company data and Barclays Research Estimates

On a volume basis, Qunar has made great strides because of its market place nature, and has surpassed Ctrip in air ticket sales. However, based on sales, Ctrip is still far ahead of QUNR. This signals that Qunar has lower revenue per flight product mix, and are most likely focused on domestic, short hauls versus international, long hauls. For QUNR to catch up, it must move up the value chain, and take market share away from Ctrip, which it has not been able to do so far.

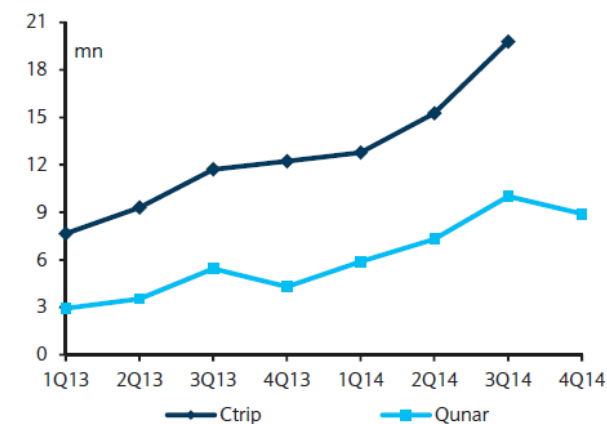
In the hotel reservation segment, Ctrip is the clear leader in terms of volume and revenue. Although Qunar's growth far exceeds that of any competitor in the hotel space, it is growing off a small base, and as the low hanging fruits are exhausted, Qunar may find it tougher to actually take market share from the top two players, Ctrip and eLong.

Qunar vs Ctrip air ticketing volume



Source: Company data, Barclays Research estimates for Ctrip

Qunar vs Ctrip hotel room night volume



Source: Company data, Barclays Research estimates for Ctrip

- **Uncontrollable events:** Events such as pandemics and political unrests can jeopardize the online travel industry and therefore, Qunar.

Valuation and Assumptions

Our key forecast assumptions are listed in the table below:

Key Metrics	2015	2016	2017	2017	2019
Sales growth rate	34.6%	41.9%	33.4%	26.2%	22.2%
Gross margin	72.5%	72.5%	72.5%	72.5%	72.5%
S&M expenses (as a % of sales) (1)	61.0%	32.0%	21.0%	19.0%	11.0%
G&A expenses (as a % of sales)	20.9%	17.0%	15.0%	13.0%	13.0%
R&D expenses (as a % of sales)	39.0%	30.0%	27.0%	25.0%	23.5%
Air tickets sold - marketplace(in mm)	115.0	160.0	200.0	230.0	260.0
Total air ticket market share %	26.1%	33.3%	38.5%	41.1%	43.4%
Online air ticket market share %	39.6%	44.4%	48.7%	50.1%	51.1%
Hotel nights sold - marketplace(in mm)	52.8	82.8	105.6	117.6	136.0
Total air ticket market share %	10.2%	15.1%	18.4%	19.5%	21.5%
Online air ticket market share %	20.3%	23.3%	26.2%	26.0%	26.3%
Hotel nights sold - OTA(in mm)	2.2	7.2	14.4	22.4	34.0
Total air ticket market share %	0.4%	1.3%	2.5%	3.7%	5.4%
Online air ticket market share %	0.8%	2.0%	3.6%	5.0%	6.6%
Digital display - num of advertisers	210	234	256	276	294
Digital display - revs per advertiser (in mm)	0.54	0.61	0.69	0.76	0.83
Number of users	291.0	324.0	349.0	366.0	375.0
Revenue per 1000 queries (web-flight)	250.0	250.0	250.0	250.0	250.0
Average num of queries per user	9.6	9.1	8.6	8.1	7.6
Revenue per 1000 queries (web-hotel)	1,040.7	1,040.7	1,040.7	1,040.7	1,040.7
Average num of queries per user	1.1	1.2	1.2	1.3	1.3
Revenue per 1000 queries (mobile-flight)	180.0	182.5	185.0	187.5	190.0
Average num of queries per user	12.1	19.1	26.1	33.1	40.1
Revenue per 1000 queries (mobile-hotel)	375.4	395.4	415.4	435.4	455.4
Average num of queries per user	4.6	5.6	6.6	7.6	8.6
Gross margin	72.5%	72.5%	72.5%	72.5%	72.5%
S&M expenses (as a % of sales) (1)	61.0%	32.0%	21.0%	19.0%	11.0%
G&A expenses (as a % of sales)	20.9%	17.0%	15.0%	13.0%	13.0%
R&D expenses (as a % of sales)	39.0%	30.0%	27.0%	25.0%	23.5%
Effects of options and dilutive securities	2.075				
Cash Balances: interest rate	2.00%				

Business segment projections

1. Industry Online Penetration Rate

Online Penetration Rate: As the internet adaptation rate accelerates, we believe both air-ticket and hotel booking online penetration rate will reach over 80% in 2019, leaving around less than 20% market share for offline booking (walk-in booking, phone booking and corporate travels). After 2019, the online travel market share will continue to increase, but at a more modest rate.

Airline Ticket Analysis

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total no. of air tickets sold (in mm)	306	331	366	400	440	481	520	560	599
YoY Growth		8.2%	10.6%	9.3%	10.0%	9.3%	8.2%	7.6%	7.0%
Average price per ticket	1,157	1,121	1,100	880	880	885	890	895	900
Online penetration	23.1%	28.1%	42.0%	60.0%	66.0%	75.0%	79.0%	82.0%	85.0%

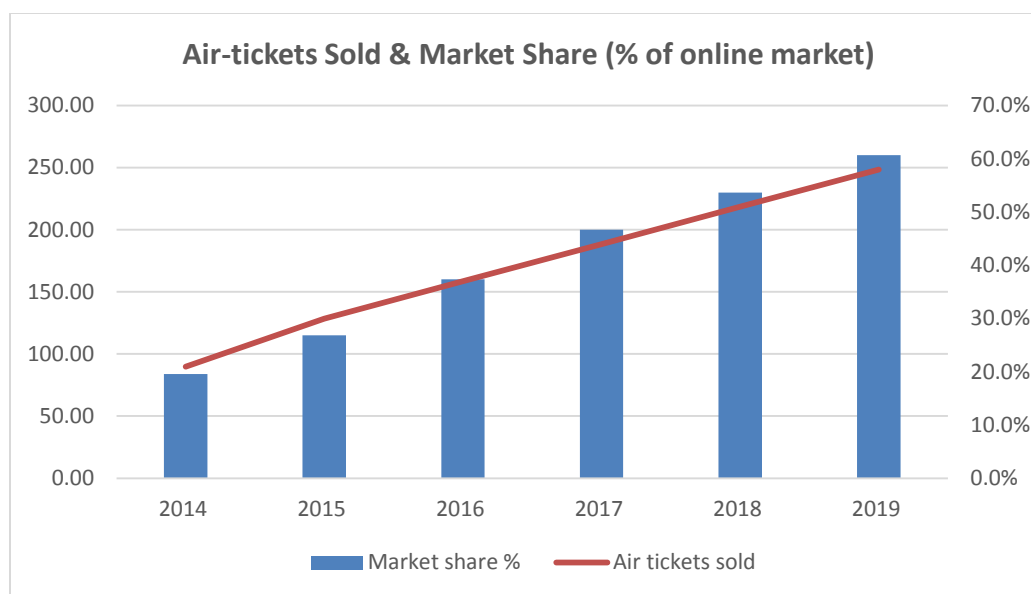
Hotel Analysis

	2011	2012	2013	2014	2015E	2016E	2017E	2018E	2019E
Hotel room nights sold (in mm)	422.0	436.0	462.0	490.0	519.4	546.9	574.8	603.0	631.3
YoY Growth		3.3%	6.0%	6.1%	6.0%	5.3%	5.1%	4.9%	4.7%
Average price per hotel night	464	409	443	420	420	430	440	450	460
Online penetration	16.3%	22.3%	23.7%	40.0%	50.0%	65.0%	70.0%	75.0%	82.0%

2. Air-ticket P4P Segement

Qunar Market Share: We believe Qunar will continue its domination in this segment. We assume the company will account for 43.5% of the total number of air tickets sold in China (or 51.1% of the online market) in 2019 based on:

- **Qunar leading position in the mobile internet space.** We expect Qunar will account for more than 45% (currently at 40%) of the total user traffic; given Qunar's leading marketplace position in air ticket, it is reasonable to assume a 51% online market share.
- The China airline industry is less fragmented than hotels in nature and travelers usually have more homogenous needs; Qunar's marketplace model makes it an ideal place for travelers to compare on price.



Web Revenue: We expect Qunar's web search queries will stay flat in 2019 compared to 2015 mainly due to the traffic migration to mobile offset by the strong new user growth. Similarly, we expect revenue per 1000 queries will stay flat due to the mobile migration partially offset by Qunar's increasing pricing power. We project Qunar's future web air ticket revenue (num of queries in 1,000 x revenue per 1000 queries) to grow at a CAGR of 3.2% in the next 5 years. Revenue will grow from 611.75 mm to 716.14 mm, which reflects our view that web traffic will not be the main growth engine for Qunar.

		Projected Year Ending December 31,				
	2014	2015	2016	2017	2018	2019
Web-Flight	611.75	701.22	740.24	753.74	744.70	716.14
% yoy growth	29.0%	14.6%	5.6%	1.8%	-1.2%	-3.8%
% of total web revenue	68.5%	67.2%	65.0%	62.8%	60.4%	58.0%
Web search queries (mn)	2,534.70	2,804.89	2,960.97	3,014.94	2,978.80	2,864.55
% yoy growth	24.3%	10.7%	5.6%	1.8%	-1.2%	-3.8%
No. of users (mn)	250.00	291.00	324.00	349.00	366.00	375.00
Average queries per user	10.14	9.64	9.14	8.64	8.14	7.64
Revenue per 1000 queries (Rmb)	241.35	250.00	250.00	250.00	250.00	250.00
% yoy growth	3.8%	3.6%	0.0%	0.0%	0.0%	0.0%

Mobile Revenue: The Company's web traffic will stay flat based on users' behavioral shift. In 2019, web queries on flight will increase from 2015's 2.5 billion to 2.8 billion. We expect user engagement frequency on the mobile side will increase at a very high speed due to this behavioral shift, average queries per user will increase to 40 per year in 2019. We believe revenue per 1000 queries will be lower in mobile than PC due because mobile search is more casual and fragmented, which leads to a higher queries to lead ratio. We project Qunar's future mobile air ticket revenue (num of queries in 1,000 x revenue per 1000 queries) to grow at a CAGR of 62% in the next 5 years. Revenue will grow from 232.65 mm to 2859.69 mm, which reflects our view that mobile traffic will be the main growth engine for Qunar.

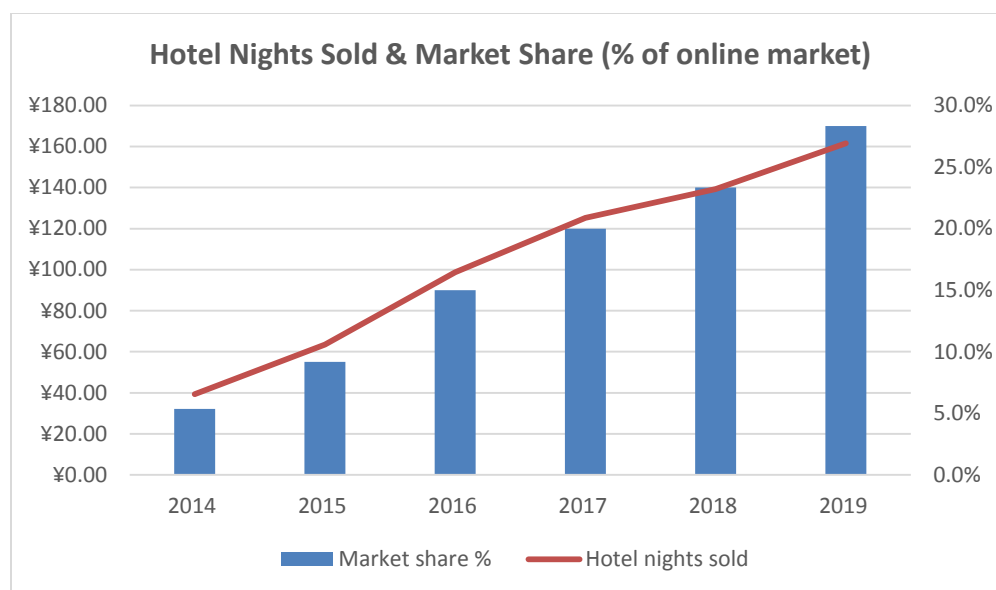
		Projected Year Ending December 31,				
	2014	2015	2016	2017	2018	2019
Mobile-Flight	232.65	635.68	1,131.51	1,687.47	2,273.96	2,859.69
% yoy growth	313.1%	173.2%	78.0%	49.1%	34.8%	25.8%
% of total mobile revenue	42.1%	55.8%	61.1%	63.8%	65.2%	66.1%
Mobile search queries (mn)	1,284.00	3,531.58	6,200.06	9,121.46	12,127.78	15,051.00
% yoy growth	136.9%	175.0%	75.6%	47.1%	33.0%	24.1%
No. of users (mn)	250.00	291.00	324.00	349.00	366.00	375.00
Average queries per user	5.14	12.14	19.14	26.14	33.14	40.14
Revenue per 1000 queries (Rmb)	181.19	180.00	182.50	185.00	187.50	190.00
% yoy growth	74.4%	-0.7%	1.4%	1.4%	1.4%	1.3%

Model Triangulation: We tried to triangulate our assumptions and take the perception of Qunar's clients: OTAs. Our assumptions generated a slight decline lead in queries ratio due to the surge in mobile queries (conversion rate in the mobile space is lower). From an OTA's perspective, the OTA acquisition cost per lead will increase from 10.06 RMB to 13.75 RMB, which reflects Qunar's increasing pricing power in the air ticket space.

	Projected Year Ending December 31,					
	2014	2015	2016	2017	2018	2019
QUNR air-ticket nights sold	83.90	115.00	160.00	200.00	230.00	260.00
Market share %	21.0%	30.0%	37.0%	44.0%	51.0%	58.0%
Revenue per air ticket	10.06	11.63	11.70	12.21	13.12	13.75
Leads to queries ratio	2.20%	1.81%	1.75%	1.65%	1.52%	1.45%
OTA acquisition cost per query	0.22	0.21	0.20	0.20	0.20	0.20
OTA acquisition cost per lead	10.06	11.63	11.70	12.21	13.12	13.75
Comission	1.1%	1.3%	1.3%	1.4%	1.5%	1.5%

3. P4P Segment: Hotels

Qunar Market Share: Unlike its absolute domination in the airline industry, we believe CTRP actually has the edge over Qunar in the hotel space thanks to Ctrip's industry leading position and its strong relationship with major hotels vendors. For example, Rujia Hotel Group, one of the largest economic hotel chain, decided to sign an exclusive cooperation agreement with Ctrip. We expect Qunar will obtain close to a quarter of the hotel market in 2019. Qunar currently accounts for 7% of total hotel nights sold in China, this dramatically increase in market share is due to the increasing online/mobile penetration rate as well as Qunar's network/air ticket cross sale effect. The Company's mobile apps will be the main traffic driver in the future, in 2019, mobile will generate almost 70% of the user traffic given travelers' user behavior shifting to mobile.



Web Revenue: On the web side, similar to air ticket, we do expect the frequency of user engagement to stay flat, mainly due to the traffic migration to mobile offset by the strong new user growth. Similarly, we expect revenue per 1000 queries will stay flat due to the mobile migration partially offset by Qunar's increasing pricing power. We project Qunar's

future web hotel revenue (num of queries in 1,000 x revenue per 1000 queries) to grow at a CAGR of 13.4% in the next 5 years. Revenue will grow from 281 mm to 591 mm. The growth rate is higher than the air ticket sector due to the smaller base of the hotel sector, which again reflects our view that web traffic will not be the main growth engine.

		Projected Year Ending December 31,				
	2014	2015	2016	2017	2018	2019
Web-Hotel	281.00	342.23	397.90	446.76	487.57	519.07
% yoy growth	96.5%	21.8%	16.3%	12.3%	9.1%	6.5%
% of total web revenue	31.5%					
Web search queries (mn)	270.00	328.83	382.32	429.27	468.48	498.75
% yoy growth						
No. of users (mn)	250.00	291.00	324.00	349.00	366.00	375.00
Average queries per user	1.08	1.13	1.18	1.23	1.28	1.33
Revenue per 1000 queries (Rmb)	1,040.74	1,040.74	1,040.74	1,040.74	1,040.74	1,040.74
% yoy growth	47.7%	0.0%	0.0%	0.0%	0.0%	0.0%

Mobile Revenue: The Company's web traffic will increase slightly based on users' behavioral shift. In 2019, web queries on flight will increase from 2015's 281 million to 367 million. We expect user engagement frequency on the mobile side will increase at a very high speed due to this behavioral shift, average queries per user will increase to 40 per year in 2019. We believe revenue per 1000 queries will be lower in mobile than PC due because mobile search is more casual and fragmented, which leads to a higher queries to leads ratio. We project Qunar's future mobile air ticket revenue (NUM of queries in 1,000 x revenue per 1000 queries) to grow at a CAGR of 35.6% in the next 5 years. Revenue will grow from 232.65 mm to 2859.69 mm, which reflects our view that mobile traffic will be the main growth engine for Qunar.

	2014	2015	2016	2017	2018	2019
Mobile-Hotel	319.90	503.66	719.42	959.11	1,212.83	1,468.81
% yoy growth	447.8%	57.4%	42.8%	33.3%	26.5%	21.1%
% of total mobile revenue	57.9%	44.2%	38.9%	36.2%	34.8%	33.9%
Mobile search queries (mn)	900.00	1,341.51	1,819.26	2,308.64	2,785.26	3,225.00
% yoy growth						
No. of users (mn)	250.00	291.00	324.00	349.00	366.00	375.00
Average queries per user	3.60	4.61	5.62	6.62	7.61	8.60
Revenue per 1000 queries (Rmb)	355.44	375.44	395.44	415.44	435.44	455.44
% yoy growth	34.5%	5.6%	5.3%	5.1%	4.8%	4.6%

Model Triangulation: We tried to triangulate our assumptions and take the perception of Qunar's clients: OTAs. Our assumptions generated an inclining leads to queries ratio due to Qunar's better data analytic result. We also see OTA's acquisition cost per lead increasing due to 1. Higher leads to queries conversion rate and 2. Pricing power shifts to Qunar after market consolidation.

	Projected Year Ending December 31,					
	2014	2015	2016	2017	2018	2019
QUNR hotel nights sold	32.10	55.00	90.00	120.00	140.00	170.00
Market share %	6.6%	10.6%	16.5%	20.9%	23.2%	26.9%
Market place nights sold	32.10	52.80	82.80	105.60	117.60	136.00
Revenue per hotel night	18.72	16.02	13.49	13.31	14.46	14.62
Leads to queries ratio	2.7%	3.2%	3.8%	3.9%	3.6%	3.7%
Average queries per user	0.84	1.18	1.53	1.88	2.20	2.49
OTA acquisition cost per lead	30.54	37.31	40.76	48.75	60.98	68.15

4. OTA - Hotel Booking

In addition, we believe around 20% of the hotel nights booked in 2019 will be from Qunar's own OTA services, OTA mode has a much higher revenue per hotel night than the marketplace model. We assume average hotel prices will increase slightly from 420 RMB to 450 RMB in 5 years (mainly because of rising property prices) and a 7% commission rate. We project the 2019 OTA revenue to be 1094 mm RMB (OTA nights sold x commission rate x average hotel price).

	Projected Year Ending December 31,					
	2014	2015	2016	2017	2018	2019
OTA Revenue	-	66.22	221.76	453.60	721.28	1,094.80
OTA (% of total QUNR hotel sold)	0.0%	4.0%	8.0%	12.0%	16.0%	20.0%
OTA nights sold	-	2.20	7.20	14.40	22.40	34.00
Commissions	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Hotel average price	420.00	430.00	440.00	450.00	460.00	460.00

5. Digital Display

As Qunar gains more user traffic it will become more attractive for advertisers. By 2019, the number of advertisers will increase by 70% due to its increasing influence in the travel space. The 70% increase over 5 years seems low, but we should also account for market consolidation (lots of travel agencies won't survive due to Ctrip's aggressive expansion). However, compared to the P4P segment, digital display revenue remains small.

	Projected Year Ending December 31,					
	2014	2015	2016	2017	2018	2019
Display advertising service	87.89	113.74	143.32	175.81	209.86	243.67
% yoy growth	38.4%	29%	26%	23%	19%	16%
Number of advertising customers	187	210	234	256	276	294
% yoy growth	14.0%	12.5%	11.0%	9.5%	8.0%	6.5%
Average spending per advertising customer	0.47	0.54	0.61	0.69	0.76	0.83
% yoy growth	21.4%	15.0%	13.5%	12.0%	10.5%	9.0%

6. Cost Assumptions

GOGS margin will remain stable, Qunar's GOGS is made up of mainly bandwidth cost and personnel cost. The economics of scale effect on bandwidth will be offset by the increasing labor cost in China. We expect GOSG margin will stay around 72.5%, a little bit lower than its 2014 margin due to the increasing OTA hotel mix.

R&D and G&A: We will see operating leverage kicks in for both R&D and G&A. However, we believe the personnel cost will keep increasing due to the increasing competition for talents

in the China internet space. We assume the R&D head count will double in 2019 and personnel cost will increase by 10%.

S&M cost will decrease as a % of sales after industry consolidation and the slowdown of OTA price war. However, Ctrip will still be around and compete with Qunar in a dualopoly market, we still expect an increasing incremental acquisition cost. By 2019 when the growth of online market penetration slows down, we expect the customer acquisition cost (including the cost of maintaining the current user base) will increase from 30 RMB per user in 2014 to 85 RMB in 2019.

Ratios & Assumptions		Projected Year Ending December 31,				
Sales growth rate	106.5%	34.6%	41.9%	33.4%	26.2%	22.2%
Gross margin	74.1%	72.5%	72.5%	72.5%	72.5%	72.5%
S&M expenses (as a % of sales) (1)	108.6%	61.0%	32.0%	21.0%	19.0%	11.0%
Customer acquisition cost	30.20	25.43	20.42	37.62	63.17	84.38
G&A expenses (as a % of sales)	22.8%	20.9%	17.0%	15.0%	13.0%	13.0%
R&D expenses (as a % of sales)	43.0%	39.0%	30.0%	27.0%	25.0%	23.5%
Headcount	1,500	1,800	2,100	2,400	2,700	3,000
Cost per headcount in 1000RMB	503.33	512.36	479.45	503.83	523.35	540.83
Operating margin	-100.2%	-48.40%	-6.50%	9.50%	15.50%	25.00%
SBC expense (as a % of sales)	15.1%	14.1%	13.1%	12.1%	11.1%	10.1%
Effective tax rate	7.5%	25.0%	25.0%	25.0%	25.0%	25.0%

7. Valuation

Beta: We ran a linear regression test to obtain Qunar's beta by using $(2/3) \times \text{calculated beta} + 1/3$.

Rolling Beta				
Time Series				
Date	R-Rf	Mkt-Rf	beta	alpha
4/1/2015	0.1146	0.0186	0.812907	0.01234
3/2/2015	0.5163	-0.0134	0.802652	0.010576
2/2/2015	-0.0738	0.0703	0.990977	-0.0022
1/2/2015	0.0310	-0.0223	1.112042	-0.00077

The Risk Free Rate is 2.2% (10 year treasurer rate), equity risk premium is 6%, we also apply a China country premium of 3%, which leads to 10.1% cost of equity.

Terminal Growth Rate: We believe Qunar will slow down after years of hyper growth as the overall online penetration rate reaches a steady level. However, we still think Qunar will grow above the GDP grow rate for a considerable period of time as China's consumer economy takes off. Therefore, we assign a terminal growth rate of 4%.

The Final Number: Our DCF analysis yields \$46.44, around 0.4% higher than the current price, therefore we recommend a hold.

Discounted Cash Flow Analysis for Qunar Inc.

RMB in millions except per share/ARPU or noted in USD

		Historical Year Ending December 31,			Projected Year Ending December 31,				
		2012	2013	2014	2015	2016	2017	2018	2019
Sales		502.00	851.00	1,757.00	2,364.75	3,356.15	4,478.49	5,652.19	6,904.18
Earnings		(60.00)	(105.00)	(1,615.18)	(737.88)	(26.82)	481.02	834.26	1,495.04
OCF					(986.32)	535.02	1,152.18	1,490.97	2,105.25
EBIT		(76.00)	(153.00)	(1,761.00)	(1,144.54)	(218.15)	425.46	876.09	1,726.04
EBIDTA		(69.90)	(143.70)	(1,741.80)	(1,118.70)	(184.79)	475.35	945.84	1,819.53
Less: Taxes @	25.0%	16.0	41.0	130.8	246.3	9.3	(159.7)	(277.4)	(497.0)
Tax-effected EBIT		(129.9)	(255.7)	(3,372.0)	(2,016.9)	(393.7)	741.1	1,544.5	3,048.6
Plus: Depreciation		6.1	9.3	19.2	25.8	33.4	49.9	69.8	93.5
Plus: Amortization		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Plus: SBC		27.0	64.0	266.0	334.4	441.0	543.7	629.6	700.0
Plus: Non-cash expenses relating to free user traffic contributed by Baidu		(7.0)	(6.0)	(3.0)	(400.0)	(400.0)	0.0	0.0	0.0
Plus: Contract termination loss provision		0.0	0.0	(64.0)	(70.0)	0.0	0.0	0.0	0.0
Less: Capital expenditures		(23.5)	(39.3)	(131.8)	(177.4)	(201.4)	(268.7)	(339.1)	(414.3)
Less: Additions to definite life intangibles		0.0	0.0	(2.8)	0.0	0.0	0.0	0.0	0.0
+ / - Changes in long-term investments		0.0	0.0	(103.2)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
+ / - Changes in working capital		0.0	125.4	1,186.4	(612.1)	81.8	71.2	(49.4)	(190.5)
+ / - Changes in other assets and liabilities		0.0	16.9	(23.8)	3.5	5.7	6.5	6.7	7.2
Unlevered Free Cash Flow		(127.30)	(85.40)	(2,228.98)	(3,012.77)	(533.20)	1,043.58	1,762.09	3,144.51
Unlevered Free Cash Flow Growth Rate						(82.3%)	(295.7%)	68.9%	78.5%

Perpetuity Growth Method				P/E Multiple Method			
Beta	0.88						
Equity Risk Premium	6.02%		10.1%	Weighted average cost of capital:			10.1%
China Risk Premium	3.0%			Net present value of free cash flow (b)		¥	752.71
Risk free rate	2.2%			Exit multiple			32.0x
Discount Rate	10.1%		4.0%	Terminal value		¥	47,841.38
				Present value of the terminal value (c)		¥	29,618.19
				Long-term investments		\$	33.56
				Multiplier			1.00
				Enterprise Value		\$	4,971.92
				LESS: Net Debt (d) (e)			(67.6)
				Equity Value		\$	4,904.34
				Diluted shares:			122.952
				Equity Value Per Share (f)		\$	44.87
				Implied EBITDA Exit Multiple			
				Terminal year unlevered free cash flow		\$3,144.5	
				Weighted average cost of capital		10.1%	
				Growth rate of free cash flow after 2019		4.0%	
				2019 EBITDA		\$1,819.5	
				Implied EBITDA Exit Multiple:		29.6x	
				(\$3,144.5 x (1+4.0%)) / (\$1,819.5 x (10.1% - 4.0%)) = 29.6x			

Trading at \$46.01 as of 4/17/2015
Consensus price target of \$35.45 as of 4/17/2015

Equity Value Per Share (Perpetuity Growth Method)

Weighted average cost of capital											
	\$44.87	8.00%	9.00%	10.00%	11.00%	12.00%	13.00%	14.00%	15.00%	16.00%	
	3.0%	\$59.37	\$47.29	\$38.72	\$32.35	\$27.43	\$23.54	\$20.38	\$17.78	\$15.60	
	3.2%	\$61.92	\$48.98	\$39.92	\$33.23	\$28.10	\$24.06	\$20.80	\$18.12	\$15.88	
	3.4%	\$64.69	\$50.80	\$41.18	\$34.15	\$28.80	\$24.60	\$21.23	\$18.46	\$16.16	
	3.6%	\$67.71	\$52.75	\$42.53	\$35.12	\$29.53	\$25.16	\$21.67	\$18.82	\$16.46	
	3.8%	\$71.02	\$54.85	\$43.96	\$36.15	\$30.30	\$25.75	\$22.14	\$19.19	\$16.76	
	4.0%	\$74.65	\$57.11	\$45.49	\$37.24	\$31.10	\$26.37	\$22.62	\$19.58	\$17.08	
	4.2%	\$78.68	\$59.57	\$47.12	\$38.39	\$31.95	\$27.01	\$23.12	\$19.98	\$17.40	
	4.4%	\$83.15	\$62.24	\$48.87	\$39.61	\$32.84	\$27.69	\$23.64	\$20.40	\$17.74	
	4.6%	\$88.14	\$65.15	\$50.75	\$40.91	\$33.78	\$28.39	\$24.19	\$20.83	\$18.08	
	4.8%	\$93.76	\$68.33	\$52.77	\$42.29	\$34.77	\$29.13	\$24.76	\$21.28	\$18.44	
	5.0%	\$100.13	\$71.84	\$54.95	\$43.76	\$35.82	\$29.91	\$25.35	\$21.74	\$18.82	
	5.2%	\$107.40	\$75.72	\$57.32	\$45.34	\$36.93	\$30.73	\$25.98	\$22.23	\$19.20	
	5.4%	\$115.80	\$80.03	\$59.89	\$47.02	\$38.11	\$31.59	\$26.63	\$22.73	\$19.60	
	5.6%	\$125.60	\$84.84	\$62.70	\$48.83	\$39.36	\$32.50	\$27.31	\$23.26	\$20.02	

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