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CTRP - Q1 2017 Ctrip.Com International Ltd Earnings Call

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OVERVIEW:

Co. reported 1Q17 net revenues of CNY6.1b or \$884m, net income attributable to Co.'s shareholders of CNY82m or \$12m, and diluted earnings per ADS of CNY0.15 or \$0.02.



MAY 11, 2017 / 12:00AM, CTRP - Q1 2017 Ctrip.Com International Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q1 Ctrip.com International, Ltd. Earnings Conference Call. My name is Maureen, and I will be your operator for today. (Operator Instructions) I would now like to turn the conference over to Cecilia Zhang, Investor Relations Manager. Please proceed.

Cecilia Zhang

Thank you, Maureen. Good morning, and welcome to Ctrip's First Quarter 2017 Earnings Conference Call. Joining me today on the call are Mr. James Liang, Executive Chairman of the Board; Ms. Jane Sun, Chief Executive Officer; and Ms. Cindy Wang, Chief Financial Officer.

During this call, we will discuss our future outlook and performance which are forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, our results may be materially different from the views expressed today. A number of potential risks and uncertainties are outlined in Ctrip's public filings with the Securities and Exchange Commission. Ctrip does not undertake any obligation to update any forward-looking statement, except as required under applicable law.

James, Jane and Cindy will share our strategy and business updates, operating highlights and the financial performance for the first quarter as well as the outlook for the second quarter of 2017. After the prepared remarks, we will have a Q&A session.



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With that, I will turn the call over to James for our business updates. James, please.

Jianzhang Liang - *Ctrip.com International, Ltd. - Co-Founder and Executive Chairman*

Thank you, Cecilia, and thanks to everyone for joining us today on the call. We kicked off 2017 with great results. Net revenues were up 46% year-over-year in the first quarter, driven by solid organic growth and the inclusion of Skyscanner.

Non-GAAP operating margin was 15% for the quarter, improving significantly from 0% in the same period a year ago. In the following discussion, I'd like to share some updates on Ctrip's progress into -- expanding into lower-tier cities and into international markets.

The booming travel market in lower-tier cities continues to offer growth opportunities for Ctrip. A recent survey conducted by China Central Television shows that travel has been ranked #1 in Chinese consumer's personal spending list for 3 consecutive years. In addition, the travel demand in the second- and third-tier cities is catching up quickly with close to half of the local customers showing interest in travel in 2017. We are excited about this trend and have made great strides in solidifying our leadership and gaining more market share in China, especially in lower-tier cities. Ctrip is dedicated to provide the most comprehensive product offerings with a competitive pricing in targeted lower-tier cities. Along with advertising, we have also run promotions and campaigns across business segments to raise brand awareness in these tier markets. These efforts have effectively stimulated local travel demand. The number of room nights booked in the most recent quarter -- in the most popular lower-tier cities, our average grew 100% year-over-year during the Labor Day holiday.

Next, I would like to comment on our international business development. Ctrip's outbound travel business has maintained a strong growth momentum in 2017, and our international expansion is further enhanced by the Skyscanner investment. We are working closely with the company to develop a direct-to-booking capacity for air ticketing. In the future, Skyscanner will collaborate more closely with its business partners by allowing them to operate storefronts on its platform. The new approach will bring a seamless booking experience. The results of the early entry -- early trials have been encouraging. Skyscanner has seen strong uplift in conversion rates, ancillary upsell and mobile bookings for the partners. The direct-to-booking facility will be fully available in the second half of the year. Ctrip will leverage Skyscanner's platform to better serve travelers around the world.

In order to provide the talent support for our international expansion, Ctrip announced the establishment of the international talent center in April. We will both develop the young leaders internally and recruit candidates overseas.

Ctrip has been making solid improvements over the past 17 years. We are confident that we will continue along the path and achieve great success in both domestic and international travel markets in the future.

With that, I will turn the call over to Jane for business highlights.

Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Thanks, James. Hello, everyone. I'm pleased to update you with the development of Ctrip's main business lines.

First, hotel and other accommodations. Total hotel revenue grew by 28% compared to the same period last year, driven by volume growth. This quarter's growth rate reflected a negative impact of approximately 5% to 10% due to the adoption of the VAT tax. At the end of the first quarter, Ctrip's domestic hotel coverage reached 540,000 hotels, increasing by almost 30% over a year ago. The investments we made in penetrating into the second-tier and third-tier cities has started to bear fruit. Qunar's hotel revenue in the third- and fourth-tier cities increased around 90% year-over-year in the first quarter.

Ctrip never stops innovating. The accommodation team recently introduced the easy stay strategy and launched several new products and services, including online room selection, invoice preordering and automated check-in and checkout machines, et cetera. These initiatives have incorporated Ctrip's advanced IT technology and will further differentiate us from other players in the market.



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Second, transportation ticketing services. Total transportation revenue grew by 48% year-over-year in the fourth quarter, benefiting from the fast-growing new business units and inclusion of Skyscanner. Air ticketing delivered a solid growth. We have continued to optimize our best-in-class services. Recently, we opened a new service center in Weihai devoted to automated customer support in air ticketing. It includes service efficiency and increased convenience for our customers. Also, a recent survey showed the ancillary service provided by the platform have been well received by our customers. Over 50% of the travelers who bought the IP product expressed their interest in a repeat purchase.

Ground transportation, including train ticketing, bus ticketing and car rental, achieved over 100% revenue growth year-over-year in the first quarter. These businesses have also been accelerating their international expansion. Train ticketing and bus ticketing have both extended their coverage outside of Mainland China. Our international car rental businesses have partnered with over 500 suppliers worldwide and achieved approximately 300% year-over-year growth in the first quarter. In addition, we have continued to strengthen our multi-modal transportation offerings. In April, we added the bus-plus-train product to our platforms which helped transport our customers to lower-tier cities and counties where the final leg of their journey are not covered by train.

Third, packaged tours. Packaged tour revenue increased steadily, up 26% year-over-year due to the healthy volume growth. Together with Traveling Bestone, Ctrip pioneered the new retail model in the travel space, which seamlessly integrated online products with off-line services. Traveling Bestone has over 5,500 off-line franchise stores in 23 provinces and municipalities across China. The majority of which are in the second-tier and third-tier cities. These stores are generating healthy profits. We plan to open 1,000 more off-line franchise stores nationwide where customers can enjoy one-on-one services from professional consultants and access over 700,000 products from more than 20,000 travel agencies around the world.

In 2017, our packaged tour team will invest further in procurement, distribution, product development and service innovation. By working together with our partners, we will focus on improving industry efficiency, extending our customer base, enhancing product sourcing and delivering high-quality offerings.

Fourth, corporate travel. The corporate travel business delivered a solid year-over-year growth of 25%. The corporate travel market in China continues to grow rapidly. According to recent reports established by global travel -- Global Business Travel Association, China will replace the U.S.A. to become the largest corporate travel market in 2017.

Ctrip is well positioned to benefit from this favorable secular trend. Our corporate travel team is dedicated to strengthening our competitiveness of our platform and open to collaborating with all parties involved to create more value for our corporate customers.

In March, the team announced a cooperative agreement with China Eastern Airlines for a deepened collaboration in client service and product sharing. The 2 parties will also explore new opportunities to optimize and upgrade corporate travel services in the future.

The year of 2017 is shaping up to become another remarkable year. The group will continue to work hard to penetrate into the lower-tier cities and expand internationally with our customers. These endeavors will further widen our competitive moat and strengthen our leadership in China travel industry.

As always, we would like to thank our customers, business partners, employees and shareholders for their continued support. We will work hard and deliver great results in the years to come.

With that, I will turn the call over to Cindy for financial highlights.

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Thank you, Jane. Thank you, everyone. For the first quarter of 2017, Ctrip reported net revenue of RMB 6.1 billion or USD 884 million, representing a 46% increase from the same period in 2016. Net revenues for the first quarter of 2017 increased 20% from the previous quarter.



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Accommodation reservation revenues for the first quarter of 2017 were RMB 2.1 billion or USD 301 million, representing a 28% increase from the same period last year, primarily driven by increase in accommodation reservation volume. Accommodation reservation revenues for the first quarter of 2017 increased 12% from the previous quarter, primarily due to seasonality.

Transportation ticketing revenues for the first quarter of 2017 were RMB 2.9 billion or USD 418 million, representing a 48% increase from the same period in 2016, primarily driven by an increase in ticketing volume and the consolidation of Skyscanner. Transportation ticketing revenues increased 18% from the previous quarter, primarily due to seasonality and the consolidation of Skyscanner.

Packaged tour revenues for the first quarter of 2017 were RMB 702 million or USD 102 million, representing a 26% increase from the same period in 2016, primarily driven by increase in volume growth of organized tours and self-guided tours. Packaged tour revenues for the first quarter of 2017 increased 50% from the previous quarter, primarily due to seasonality.

Corporate travel revenue for the first quarter of 2017 were RMB 144 million or USD 21 million, representing a 25% increase from the same period in 2016, primarily driven by expansion in travel product coverage. Corporate travel revenues for the first quarter of 2017 decreased 19% from the previous quarter, primarily due to seasonality.

Gross margin was 80% for the first quarter of 2017 compared to 73% in the same period last year and 78% in the previous quarter. Product development expenses for the first quarter of 2017 decreased by 18% to RMB 2 billion or USD 285 million from the same period last year, primarily due to a decrease in share-based compensation charges. Product development expenses for the first quarter of 2017 increased 14% from the previous quarter, primarily due to an increase in product development personnel-related expenses. Product development expenses for the first quarter of 2017 accounted for 32% of the net revenues.

Excluding share-based compensation charges, non-GAAP product development expenses for the first quarter of 2017 accounted for 28% of the net revenues, which decreased from 32% in the same period last year and increased from 27% in the previous quarter.

Sales and marketing expenses for the first quarter of 2017 increased by 22% to RMB 1.9 billion or USD 273 million from the same period last year and increased 28% from the previous quarter, primarily due to an increase in sales and marketing-related activities. Sales and marketing expenses for the first quarter of 2017 accounted for 31% of the net revenues. Excluding share-based compensation charges, non-GAAP sales and marketing expenses for the first quarter of 2017 accounted for 30% of the net revenues, which decreased from 33% in the same period last year and increased from 28% in the previous quarter.

G&A expenses for the first quarter of 2017 decreased by 31% to RMB 638 million or USD 93 million from the same period last year, primarily due to a decrease in share-based compensation charges. G&A expenses for the first quarter of 2017 increased 18% from the previous quarter. G&A expenses for the first quarter of 2017 accounted for 10% of the net revenues. Excluding share-based compensation charges, non-GAAP G&A expenses accounted for 7% of the net revenues, which decreased from 8% in the same period last year and remained consistent with the previous quarter.

Income from operations for the first quarter of 2017 was RMB 414 million or USD 60 million compared to a loss of RMB 1.8 billion in the same period last year and income of RMB 207 million in the previous quarter. Excluding share-based compensation charges, non-GAAP income from operations was RMB 936 million or USD 136 million compared to RMB 8 million in the same period last year or RMB 797 million in the previous quarter.

Operating margin was 7% for the first quarter of 2017 compared to negative 44% in the same period last year and 4% in the previous quarter. Excluding share-based compensation charges, non-GAAP operating margin was 15% compared to 0% in the same period last year and 16% in the previous quarter.

Income tax expenses for the first quarter of 2017 was RMB 148 million or USD 22 million compared to RMB 94 million in the same period of last year and RMB 110 million in the previous quarter. The change in the group effective tax rates from year-over-year is primarily attributable to the tax differentiation from certain subsidiaries with preferential tax rates as well as the nondeductible expenses.



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Net income attributable to Ctrip's shareholders for the first quarter of 2017 was RMB 82 million or USD 12 million compared to net loss of RMB 1.6 billion in the same period last year and net income of RMB 645 million in the previous quarter.

Diluted earnings per ADS were RMB 0.15 or USD 0.02 for the first quarter of 2017. Excluding share-based compensation charges, non-GAAP diluted earnings per ADS were RMB 1.09 or USD 0.16 for the first quarter of 2017. As of March 31, the balance of cash and cash equivalents, restricted cash and short-term investments was RMB 36 billion or USD 5 billion.

With that, operator, please open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is from the line of Amanda Chen.

Amanda Chen - Morgan Stanley, Research Division - Equity Analyst

My question is regarding the international market. The first one is, I think, James, you mentioned that -- you shared some updates on the international expansion, especially the development of Skyscanner. I'm wondering could you share some updates in other areas such as the development of Ctrip's organic urban travel business and then the cooperation with MakeMyTrip and Priceline, et cetera. And then the second question is, we noticed that you have lots of cash sitting on the balance sheet. I think the stock performance is quite good as well. And if I read the number correctly, I think you borrowed around like RMB 4 billion short-term loan in -- for the quarter. So shall we expect more international M&A to come in the near term? And if so, what kind of company that Ctrip might prefer? Is it a company with more online traffic and content? Or is it a company with more off-line resources?

Jianzhang Liang - Ctrip.com International, Ltd. - Co-Founder and Executive Chairman

Yes. The international market will be a huge opportunity for growth for years to come. Our strategy, first, is to develop a more complete product offering. China will be the largest travel market in the world, and our scale advantage will give us an advantage in providing product services to non-Chinese customers, especially in East Asia, who typically travel to similar destinations as Chinese. Second, we'll work closely with partners to offer one-stop travel service globally, for example, Skyscanner, and also, for example, we'll continue to work very closely with Priceline to offer hotel products throughout the world, especially in non-Asia regions. And lastly, we'll invest heavily in technology and innovation. And we are open to investing and partnering with the technology and travel product leaders in the world. Our goal is to become most successful travel brand -- one of the most successful travel brands in Asia and one of the most successful travel companies in the world.

Operator

Your next question comes from the line of Ronald Keung.

Ronald Keung - Goldman Sachs Group Inc., Research Division - Executive Director

Could you just give us the 2Q guidance and outlook on your revenue growth expectation by segment? We see very strong gross margins, do you think this is sustainable? And usually -- seasonality-wise, should we expect gross margins to maintain such strength? Also, the 2 cost items on sales and marketing that has declined quite a bit and the share-based compensation has fallen quite a bit, and so the marketing has gone up quite a bit. Could you just give us some sort of expectations into the next few quarters?



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Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Sure. So our net revenue will grow at a similar pace moving toward the second quarter of this year. Our net revenue will grow 40% to 45% year-over-year. With respect to each business line items, please note that there's -- the following guidance actually included 5% to 10% negative VAT tax impact. So for the accommodation reservation business, we expect to have a 25% to 35% year-on-year revenue growth. And for the transportation ticketing business, we expect to have 40% to 50% year-over-year growth and packaged tour to have 20% to 30%, and Corporate travel will maintain a very solid growth at around 15% to 25% year-over-year growth. And Ctrip will continue to be very disciplined on the cost side and expect it to deliver RMB 900 million to RMB 1 billion in the non-GAAP operating profit. You already see we achieved savings in efficiency improvements in -- of almost all business line -- expenses line items. And the reason why share-based compensation dropped significantly is because in the first quarter last year, Ctrip group had the one-time share-based incentive plan, and that is the impact. And for the sales and marketing expenses, yes, we always closely monitor each sales marketing channels in terms of the ROI. Once the ROI is positive, we will continuously to make investment. But moving into this year, as James and Jane both said, we will very decisively make investment in the second- and third-tier cities because we see huge potentials in those comparatively lower market.

Operator

Your next question comes from the line of Jed Kelly.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director and Senior Analyst*

Just touching around, I guess, on the expansion or into the lower-tier cities. Can you talk about the ROI trends you're seeing in the Tier 2 and Tier 3 cities as you aggressively expand? And are you seeing any positive ROI in those cities?

Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Sure. Thanks, Jed. Our approach has always been to start our business with the most profitable segment. So Ctrip, in the past, have been very successful starting our business in Shanghai, Beijing, Guangzhou, Shenzhen and the coastal area where the buying power is very strong. So Ctrip platform probably accumulates the most affluent customers on our platform. Now going forward, the second-tier, third-tier cities, their GDP per capita is also growing. So we will decisively invest in these areas. All these cities represents new markets and new opportunities for us. And our strategy are twofold. First of all, we will extend our product offering into these cities, not only in hotels but also in train tickets, bus tickets, ferry, rental car, et cetera. So our belief is if we provide this comprehensive products for these lower-tier cities, it will be a very powerful product offering for the customers that will grow into our platform. Secondly for these cities, we have not had invested heavily in our branding in the past. Now our sales and marketing team are penetrating further into these cities, and the results have been very promising. The year-over-year growth in these cities has been 3 digits. So for these new areas, which represents a new market for us, we will aggressively make our investment. And our guidance had already reflected these investments.

Operator

Your next question comes from the line of Natalie Wu.

Yue Wu - *China International Capital Corporation Limited, Research Division - Analyst*

Two quick questions here. The first one is about the growth of accommodation service. It seems to be accelerated if we compare it to the guidance you gave us for the first quarter 3 months ago versus the second quarter you just mentioned. So just wondering what is the reason behind. And secondly, about the recent CCA issue, so just wondering will it have any kind of impact on the take rate of your airline ticketing business?



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Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes. So for the first question, because of our investments, as Jane said, in the second, lower-tier cities, we see very promising growth in the lower-tier cities in the hotel bookings. That's one of the reasons why you see kind of acceleration of our growth in those -- especially in the lower-tier markets. And your second question regarding the air tickets, right, it's the take rates of the air tickets?

Yue Wu - *China International Capital Corporation Limited, Research Division - Analyst*

Yes, and the impact from the CCA.

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes, yes. So firstly, Ctrip uses cross-selling practice to facilitate one-stop travel experiences, and we basically personalize the order cross-selling options. That assess customer's requirement based on their historical review and booking history. That's why we see very positive feedback from our customers. And we work continuously to improve the conversion rate as well as the customer satisfaction rate. Lastly, but most importantly, customer actually can uncheck any extra services and review their shopping list before or after they check out. So as always, we will continue to work hard to provide the better value to our customers. And as long as we continue to bridge customers with the best services to make their travel easier and Ctrip remained the most efficient and effective channels for all our suppliers, we were able to -- we will be able to keep a reasonable return based on our value proposition.

Operator

Your next question comes from the line of Wong Binnie.

Wai Yan Wong - *BofA Merrill Lynch, Research Division - Research Analyst*

So 2 questions here. First question is on the operating margin improvement between your core business and your international revenue basically from Skyscanner this quarter. So what is Skyscanner revenue contribution in this quarter? I want to understand the margin profile so we can better understand what is it -- how much is that improving in our China core business as well. So if you can share with us the revenue contribution for Skyscanner and also its margin profile, that would be very helpful. And second is that also on Skyscanner is that how has the implementation of the closed-loop system is progressing? And then a follow-up on the cross-selling activities. Besides the changes we have already seen in your booking platform, right, and what -- is it already done? Or are there any other potential changes we plan to address the announcement by the China Consumer Association? And if we think about, say, some of these ancillary services on the air ticketing, unchecked by default now, how have you seen the conversion rate has changed it? And I guess, if you can share with us more color on those, that would be very helpful.

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes, thank you, Binnie. Our operating margin has been significantly improved because -- the most important reason is because of our very successful synergies we achieved among all the invested companies including Ctrip and Qunar brand. In terms of Skyscanner, their total revenue -- their revenue contribution to Ctrip group is about mid- to high single digits. And their margin profile actually is pretty consistent with Ctrip's Chinese business. So regarding the airline cross-selling, as I said, basically Ctrip's always very curious -- always very cautious about customer's satisfaction and the conversion rate. So we keep monitoring the conversion rates as well as the customer satisfaction rate of all the customers' user behavior. What we observed is that our conversion rate and customer satisfaction rate actually continuously improve. So as always, we will continue to work very hard to provide the best product and best -- most appropriate cross-selling product to our customers.



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Operator

Your next question comes from the line of Alvin Jiang.

Unidentified Analyst

This is Maria on behalf of Alvin Jiang. So we have 2 questions here. So the first one is can management share the number of headcount currently? And what is the number target for the full year?

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

The headcount of Ctrip as a group is about 30,000, and we don't expect to add any material headcount increase. But we also -- because of the internationalization strategy, so we will continuously very actively recruit people with international experiences. And as well as the -- for the IT persons, we'll continuously very aggressively recruit more talent in those 2 areas. But overall, we don't expect any material headcount increase.

Operator

Your next question comes from the line of Chi Tsang.

Chi Tsang - *HSBC, Research Division - Head of Internet Research of Asia Pacific*

I had a couple of questions in terms of your margins. We've seen a very nice pickup in your gross margins this quarter. I was wondering if you can sort of walk us through the drivers of that. And sort of can we squeeze out more efficiencies on the gross margin side? And then, secondly, if you can reiterate for us sort of your medium- to long-term operating margin targets, and sort of which buckets are we going to see the most leverage from? Is it from SG&A? I mean, is it from sales and marketing or G&A or other areas?

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes. So for the gross margin, I think the most important reason is because in the last couple of years, we invested heavily to -- in the IT technology to automatize (sic) [automate] all the service, back-end service, offerings. From a customer's perspective, actually, if you use Ctrip, maybe you don't feel any difference between -- if a customer pick up your phone or will use like a machine to answer your basic questions. And to some extent, actually, we closely monitor, for example, the NPS, the customer satisfaction ratios, those ratios continuously improve. So that's -- this is one of the reason we kind of bear the fruit from the investment we made the last couple of years. And the second minor reason is because Skyscanner's business model, they have the metasearch model. So their gross margin -- they bring us about 1% to 1.5% increase in the gross margin. Yes. And as always, we will continuously improve our operational efficiency across all the business lines going forward. But I think the 80% gross margin has already reflected the very scalable business and efficient business models we have. So we believe that 80% will be pretty consistent, at least in the next couple of quarters. Thank you.

Operator

Your next question comes from the line of Justin Patterson.

Justin Tyler Patterson - *Raymond James & Associates, Inc., Research Division - Internet Analyst*

Two, if I may. First, on the MakeMyTrip capital raise you participated in recently. Could you talk about just what you've learned from being an investor in MakeMyTrip about penetrating the India market? And then secondly, on Skyscanner, you mentioned some of your efforts to improve



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conversion on that platform. Could you discuss how quickly that's rolling along? How quickly you expect that to reach what you're able to achieve with Qunar?

Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Sure. For MakeMyTrip, we believe India market is at the stage where China was 10 to 20 years ago. And the population is the second largest upcoming to take over as the largest population in the whole world. That is why we are very positive in the market, although it might take some time. So the investment we made in MakeMyTrip is very helpful in terms of knowledge-sharing and experience-sharing because the 2 markets have experienced intense competition, and there are a lot of things that we can share together. So we work very closely with the team by sharing our knowledge, our product, our past experience with them. And MakeMyTrip is the dominant -- is the largest OTA in India market, and we are very positive in the future they will grow very well into this faster-growing market. The second question is Skyscanner. Skyscanner and Ctrip are working very closely on the IT front to make the direct booking accessible for Skyscanner's team. And our original plan is, by the end of the year, the first booking will be pushed through. But both our IT teams worked very hard, so the first booking was pushed through a few weeks ago, much earlier than we expected. So we are very positive in moving forward to improve the service and user's experience on Skyscanner by providing the direct booking onto their sites. And so it's moving much smoother and also faster than we originally planned.

Operator

Your next question comes from the line of Alicia Yap.

Alicia Yap - *Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research*

I have a follow-up question on the margin. I think, Jane -- or Cindy, you mentioned earlier that Skyscanner margins is consistent with the Ctrip China margins. So I just wonder, is the Ctrip China margins lower than the group reported margins? So if we -- actually, excluding Skyscanner on this quarter, the reported margin will have been higher, right? So just wanted to get that sense. And then second is overall on your margins outlook. Given your continued effort to expand into the global branding and also the lower-tier cities, just wonder what would be the sales and marketing lines to be? And then will Skyscanner also have the marketing spend as well to also impact the margins?

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes. Ctrip, as always, we always continue to -- our first priority, given we're still in the very early stage of our development, we see huge potential, both domestically and internationally. So we are in the very early stage. Our top priority is still to continuously gain market share firstly in the lower-tier city of China and secondly in the international market. And so overall speaking, even with this top priority, given we already have the dominant position, especially in the China market, we are very confident that our margin will go back to the non-GAAP 20% to 30% level in the next 1 to 2 years.

Operator

Your next question comes from the line of Jialong Shi.

Jialong Shi - *Nomura Securities Co. Ltd., Research Division - Head of China Internet and Media Research and VP*

I have 2 follow-ups. For the CCA investigation, I think, Cindy, you mentioned earlier, based on your observation, the conversion rate actually has continued to improve. So just wonder, did you mean the conversion rate for the cross-selling service actually continued to improve even after you have made some adjustments recently to your practice of cross-selling in response to CCA investigation? And for the Skyscanner, I just -- I understand you're trying to transform Skyscanner from a traffic generation model to a direct booking model, which is similar to your own air ticketing service.



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I just wonder, when you talk to those overseas airlines, what are their feedback to such a change in Skyscanner's service model? Are they cooperative in terms of allowing their passengers to complete the booking, air ticketing booking, within Skyscanner's website instead of those airlines' website?

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Yes. We -- actually our air ticketing team, they are working very hard to find the most appropriate and useful product to cross sell together with the air ticket. For example, the VIP lounge services. Over 50% of the customers they choose was -- were selected -- will choose -- will add them to the next shopping, so which tells you how important and useful those cross-selling products is. And also we believe Ctrip has -- in the last couple of years, we invested heavily in terms of both the pricing as well as the comprehensiveness of our international air ticket. So overall speaking, we believe as long as we can meet or even, to some extent, always provide the product to that -- to some extent even exceed our -- some of the customer's expectation, Ctrip has the value proposition to make profit as the most efficient distribution in the air distribution industry. And regarding Skyscanner, yes, actually Skyscanner, they provide marketplaces that offer carriers very strong branding control through their storefronts, whereby carriers can actually easily display their full range of products. And at the same time, travelers will also enjoy a more seamless experience of selecting from a variety of air ticket choices. For example, the price choices or the seat selections while they're interacting with the airline -- during their bookings after they introduce the direct booking. So we believe we already see a very positive -- or the direct booking engine are very well received by all the airlines.

Operator

(Operator Instructions) Our next question comes from the line of Ming Xu.

Ming Xu - *UBS Investment Bank, Research Division - Director and Research Analyst*

I had some questions on take rate. So first of all, can you share with us the current take rate on the hotel side for Ctrip and for Qunar separately? And then given your market share in China and also the -- I -- we noticed that hotel's operations are also improving recently. Is there any plan or potential for you to further raise the take rate on the hotel side? And we also noticed that you have launched several schemes such as the step-up commission rate structure and also the prepaid hotel products. Are these products going to help you to actually raise your take rate on the hotel side? And finally...

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Thank you. So our hotel take rate has been pretty consistent. Before couponing, our gross take rate on the hotel is about 10% to 15%. But we still keep a certain level of the couponing especially in the lower-tier -- in the lower end of the market to make sure that we have the most competitive pricing in those markets. So the next take rate is about 8% to 10% on the hotel side. If you then -- yes, definitely, there's room for us to further increase our net take rate on the hotel side. But given that for the hotel business, both domestically and internationally, we are still in the very, very early stage, we have only single digits of the total market share in the hotel segment, our top priority is to further expand our market share, both domestically as well as the international hotel market. So we don't have a plan to increase significantly on the take rates. Rather, we will grow our business, mainly driven by the very healthy volume growth on the hotel side.

Operator

Your next question comes from the line of Juan Lin.



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Juan Lin - *86Research Limited - Research Analyst*

I have a follow-up question on gross margin. Could you help us to rank the gross margins of your different business lines? In particular, could you share with us the margin trend for your accommodation booking business as you continue to penetrate into lower-tier cities? And also quickly, a follow-up on the OpEx. Your plan of opening 1,000 more franchised stores, whether you are going to leverage the retail stores of Bestone or are these all brand-new stores? And how will the plan impact the outlook of OpEx?

Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Yes, these stores are franchised stores, so within 1 year they will be profitable. So the strategic value for them to bring us is coupled with our penetration into the lower-tier cities. We want to make sure it's a full product offering, penetrating strongly into the lower-tier cities. So we're not only offering air tickets and hotel, the 2 main products. We are also offering packaged tour, train, bus, ferry, rental car, et cetera. With this comprehensive product offering, we'll be able to attract more customers from the lower-tier cities. So the Bestone store in these cities will become a really valuable penetration method in terms of -- have the first-hand contact with our targeted customers.

Operator

Your next question comes from the line of Tianxiao.

Tianxiao Hou - *T.H. Capital, LLC - Founder, CEO, and Senior Analyst*

A couple questions. The first one is just regarding the transportation. It's grown really rapidly. I would like to gain some details about the contributions from different parts of transportation in both revenue and volume. What's the contribution from the train, from the bus, from the air in the revenue and volume? So that is question one. The #2 question...

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Within transportation, the reason you see very healthy or rapid growth is firstly because our small business units, including the train ticket, bus tickets and car services are -- those small business lines, they grow pretty significantly, triple-digit growth. And in terms of the volume, train ticket already surpassed the air ticket to become the largest contributor in the transportation ticketing in terms of volume. In terms of revenue, train as well as bus -- train, bus as well as car -- rental car services total contributed about 15% to 20% of our total transportation revenues. And the other reason is our addition of Skyscanner business. As you may know, Skyscanner, a vast majority of their revenue is coming from the air ticket. So that's also the reason the transportation ticket has a much higher growth rate than other business line.

Operator

Your next question comes from the line of Alex Yao.

Alex Yao - *JP Morgan Chase & Co, Research Division - Analyst*

First question is a follow-up on gross margin. So if I understand correctly, the reason for gross margin improvement this quarter are twofold. One, is that you use more machine to replace labor services in the call center, which reduced the fixed cost. And then second reason is because of the Skyscanner cost structure difference. So I think these 2 reasons are both structural and that the gross margin should be at least flattish at this level. But once we factor in the seasonality, that basically suggests that your gross margin will continue to improve in the next few quarters. Is this a correct statement? Secondly, I want to hear your thoughts on the lower-tier investment strategy. Can you talk about, from a product offering competitive landscape and the return on investment perspective, how do lower-tier city differs to the high-tier city?



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Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Sure. Thanks, Alex. So first of all, on the margin, because we push very hard to improve our IT system, the automation, robotics technology has taken off in our platform, we do have the ability to increase our scalability without adding more people. So the scale is there. So you're right, if we look at our existing portfolio, the margin improvements will be very much anticipated. However, as a fast-growing company, we always want to innovate and penetrate into the new market. So we will reserve sufficient funds and resources to penetrate into the untouched market. And these -- the second-tier and third-tier cities are our target this year. So we will use the savings on certain area and use these resources to help us to expand into the new markets in the second-tier and the third-tier cities. And your question on investment in new product and ROI. Again, we normally start with the most significant products and most significant and profitable markets. So the first-tier cities, Ctrip has very strong branding in these areas. And second-tier cities and coastal areas are also very profitable, so we have strong hold in these profitable markets. And then we were looking to the new markets, and so we penetrate further into the third-tier and fourth-tier cities. These cities are relatively green, and also GDP per capita is not reaching our original target yet. However, by taking these new markets and offering comprehensive products into these areas, along with our sales and marketing expansion, we will be able to educate these new customers and grow them into our portfolio going forward, and they will become our new customers. So the initial investment of the ROI will be lower than the matured market. But for us, these are the new markets. We are not targeting to make too much money from them. But we -- our target is aggressively gain market share. And our improved margin will enable us not only to penetrate into these lower-tier cities but also show a healthy expansion into the margin. So our goal are 3 things. First of all, aggressive top line growth. Second, expansion and healthy margin. Third, aggressive investment into the new market. So we will be able to achieve these 3 goals simultaneously through the hard work from our IT team as well as our service and product teams.

Operator

At this time, I would like to turn the conference back over to Cecilia Zhang. Please proceed.

Cecilia Zhang

Thank you to everyone for joining us today. You can find the transcript and webcast of today's call on ir.ctrip.com. We look forward to speaking with you on our second quarter 2017 earnings call. Thank you and have a good day.

Jane Jie Sun - *Ctrip.com International, Ltd. - CEO and Director*

Thank you very much for your time.

Xiaofan Wang - *Ctrip.com International, Ltd. - CFO and EVP*

Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect and have a great day.



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