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TOUR - Q4 2017 Tuniu Corp Earnings Call

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PRESENTATION

Operator

Hello, and thank you for standing by for the Tuniu's 2017 Fourth Quarter and Full Year Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. (Operator Instructions) I would now like to turn the meeting over to your host for today's conference call, Director of Investor Relations, Mary. Mary, Please go ahead.

Mary Chen - *Tuniu Corporation - IR Director*

Thank you, and welcome to our 2017 fourth quarter and full year earnings conference call. Joining me on the call today are Donald Yu, Co-Founder, Chairman and Chief Executive Officer; and Maria Xin, Chief Financial Officer. For today's agenda, management will discuss business updates, operation highlights and financial performance for the fourth quarter and full year 2017.

Before we continue, I refer you to our safe harbor statements in the earnings press release, which applies to this call, as we will make forward-looking statements. Also, this call includes discussions of certain non-GAAP financial measures. Please refer to our earnings release, which contains our reconciliations of non-GAAP measures to the most directly comparable GAAP measures. Finally, please note that, unless otherwise stated, all figures mentioned during this conference call are in RMB.

I would now like to turn the call over to our Co-Founder, Chairman and Chief Executive Officer, Donald Yu.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

Thank you, Mary. Good day, everyone. Welcome to our 2017 fourth quarter and full year earnings conference call.

We are pleased to report solid results for the fourth quarter of 2017. Net revenues increased by 46.1% year-over-year, while gross profit increased by 39.6% year-over-year. In the fourth quarter, we continued to make improvements to Tuniu's overall operating efficiency. For full year 2017, Tuniu's net revenues increased by 53.3% year-over-year, while gross profit increased by 80.9% year-over-year.

Our growth rate continues to outpace our industry peers. According to third-party research reports, Tuniu holds the highest market share in China's online leisure travel market in 2017 and continues to distance itself from other players.

2017 has been a year filled with achievements and milestones for Tuniu. On the service side, we successfully launched our own local tour operators in a number of domestic and international destinations to better serve our customers. On the distribution side, we continued to diversify our sales channels, which included opening off-line retail stores throughout China to increase efficiency in acquiring new users and engaging with existing customers. We improved our loyalty program in order to better understand and retain our customers. And lastly, on the financial side, we were

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able to reach non-GAAP profitability during the third quarter of 2017. We are pleased with these achievements and our ability to execute our strategies quickly and efficiently. We believe our commitment to these long-term strategies will allow Tuniu to develop its competitive advantage within the travel industry and truly differentiate ourselves from the other players.

Now I would like to give an update on these strategies in greater detail. First, I would like to talk about our sales network.

Last year, we made a breakthrough in our distribution network. Tuniu initially started as a company focused on acquiring users online. Starting in 2016, we launched a number of off-line retail stores in order to better serve customers who are -- customers to book increase in off-line stores.

Today, Tuniu have many forms of distribution, including our online website, mobile app, loyalty program, off-line retail stores, B2B wholesale, (inaudible) and corporate customers. With the increase in distribution channels, we are seeing a notable decrease in our blended user acquisition cost in 2017.

For our off-line retail stores, Tuniu is able to better capitalize on the brand that we have developed over the years by making engagement easier for customers in lower-tier cities. This allows us to acquire customers at a lower cost compared to online channels.

Tuniu's off-line retail stores completes our [O2O] model by giving off-line customers full access to our customer service and a complete range of products. Through close examination of our user data, we also made significant improvements to our customer loyalty program. During the fourth quarter, repeat customer contribution rates to our GMV were more than 68%, compared to less than 50% during the fourth quarter of 2016.

Also notably, in 2017, revenue from [TMC] services for corporate clients increased more than 200% year-over-year as we expanded our coverage of business throughout China. This further diversifies Tuniu's distribution. Acquiring customers at a lower cost -- at a low cost is a vital part of our growth in the future. And in 2018, we look forward to further diversifying our distribution in order to have a broader reach of customers across China.

Next, I would like to talk about our progress in our service network. Since Tuniu started to focus on its direct procurement product in 2014, we have been carefully processing up the travel supply chain. We initially started with direct procurements, transportation and accommodation components of trip and bonding them together with local tour operator products. This led to the increased efficiency by assembling these tours at the destination city instead of at the departure city. Our direct procurement as a percentage of our GMV reached 40% in 2017. We expect this percentage to reach 50% by the end of 2018.

Starting in 2016, we moved further up the travel supply chain by introducing a number of our own local tour operators in major destinations, such as Xiamen, Beijing and Changsha. As of now, we have our own local tour operators in 12 domestic destinations and 2 international destinations.

Products with Tuniu's local tour operators contributed to less than 5% of our packaged tour GMV during 2017. In the long run, we expect this to reach approximately 28% to 30%. The number of trips sold by our local tour operators was over 600,000 for full year 2017, displaying very strong growth.

Through the use of our own tour operators plus direct procurement from airliners and hotel growth, the economies of scale are increasing apparent. We are now able to procure many products at highly attractive rates and are seeing significant improvements to our pricing ability and quality control.

With our own local operators in place, we can increase our overall take rate by further controlling the pricing of our products and efficiently placing product's price on market demand.

Due to stronger purchasing power in China, consumers are demanding better and higher-quality products. Our local tour operator products meets this shift in demand. By fine-tuning these products, we can differentiate our products from those on the market and ensure that our customers have the best travel experience possible.

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2017 was just the start of our local tour operator initiative. There is a lot of room to grow, and we intend to replicate the success of our local tour operators in other domestic and international destinations.

Now I would like to talk about our strategies at travel destinations. China's travelers are becoming increasingly well traveled. With the shift -- with this shift, customers are demanding individualized products that fit their interest, often looking for this segmented products during their trip.

To capture this increased demand, Tuniu has been covering more and more destination-based products. Products such as outdoor sports, activities for children and culinary adventures can be easily bundled into our other products or ordered individually.

We also continued to increase our product coverage by further breaking down our existing products and services. Facebook-able activities and our bundling technology give our customers an -- the ability to easily customize their trip to their individual tastes. This will allow Tuniu to attract more experienced travelers and provide more choices during trips. Since many customers book products during their trip when they are less sensitive to product price, this also gives Tuniu the ability to acquire new customers at their destination.

Lastly, I wanted to briefly go over our strategy on increasing our travel-related content. To better help our customers decide on the destination, Tuniu has been developing unique travel content. This content features major attractions at destinations as well as with local activities and places to shop and eat.

We have recently introduced this content through WeChat's mini app. Having this content on Tuniu helps to convert potential customers and increasing their stickiness to Tuniu for further booking.

Another type of content that we improved on is detailed in-trip content for users that can greatly improve user experience. For example, when a customer arrives at a destination, specific information such as where to exchange currency or where to find local transportation will be provided to our users through our mobile app. Location-based activities, such as places to visit or buying, will also be provided throughout the trip.

We expect these features to improve user experience and commence Tuniu's position as the leader in China's online leisure travel market.

In 2018, we will continue to execute our cost strategies based on our long-term vision of the industry. Tuniu has lowered overall user acquisition costs through the expansion of its sales network and improved online content. We have also improved product margins through direct procurement and local tour operators, and continue to offer more choices to our customers through our destination-based products. Combining these elements, we are able to optimize the lifetime value of a customer of Tuniu.

Overall, 2017 was a strong year for Tuniu, but we are seeing some headwinds for the beginning of 2018.

External events will negatively impact our growth in the first quarter of 2018. However, Tuniu has a highly diversified destination offerings and distribution channels, so we expect the impact to be temporary and limited.

It is important to note that China's leisure travel market is still far from its full potential. By slowly defining our long-term competitive advantage, we believe Tuniu is in the best position within the industry to capture China's leisure travel market. Going into 2018, we look forward to continuing the implementation for our cost strategies of expanding our sales network, strengthening our service network and improving our technology network.

I'll now turn the call over to Maria Xin, our CFO, for the financial highlights.

Yi Xin - *Tuniu Corporation - CFO*

Thank you, Donald. Hello, everyone. Before I walk you through the financial highlights, I want to, first, give a bit more color on the guidance for the fourth quarter of 2018.

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As you know, Tuniu's net revenue has 2 components, packaged tour revenues and other revenues. The external events in Maldives, Bali and South Korea have negatively influenced our packaged tour revenues in the first of 2018. Even so, our packaged tour revenues in the fourth quarter of 2018 is expected to grow at a pace above our blended guidance gross rate and when factoring these external events.

Our other revenue, which primarily consist of the service fee received from the insurance company, revenues from the other travel-related products are expected to experience negative growth during the first quarter of 2018, largely due to the new requirement to unbundle products. As a result of this new policy, service fees from the insurance companies will significantly decline during the quarter.

As recent booking data indicates, we expect our growth rate to recover during the second quarter of 2018 as we take our customers to other destinations and as we have further diversified ourselves in terms of the product and the distribution.

Now I will walk you through the fourth quarter and full year 2017 financial results in greater detail. Please note that all the monetary amounts are in RMB, unless otherwise stated. You can find the U.S. dollar equivalent of the numbers in our earnings release.

Starting from the fourth quarter of 2017. Net revenues were CNY 469.9 million, representing 46% year-over-year growth on a non-GAAP basis. Revenues from packaged tours, which are mainly recognized on a net basis, were up 32% year-over-year on a non-GAAP basis to CNY 290.1 million and accounted for 52% of our total net revenues for the quarter. The increase was primarily due to the growth of organized tours and self-guided tours.

Other revenues were up 76% year-over-year on a non-GAAP basis to CNY 179.8 million and accounted for 38% of our total net revenue. The increase was primarily due to a raise in revenues generated from financial services and commission fees received from certain travel-related products.

Gross profit was up 40% year-over-year on a non-GAAP basis to CNY 235.2 million for the fourth quarter of 2017. The increase in gross profit was primarily due to the improved economics of scale and optimized supply chain management. Operating expenses for the fourth quarter of 2017 were CNY 456.0 million, down 40% year-over-year. Excluding the share-based compensation and amortizations of acquired intangible assets, non-GAAP operating expenses were CNY 402 million, representing a year-over-year decrease of 43%.

Research and product development expenses for the fourth quarter of 2017 were CNY 111.2 million, down 35% year-over-year. Research and product development expenses as a percentage of net revenues were 24% in the fourth quarter of 2017, decreasing from the 53% as a percentage of non-GAAP net revenue in the corresponding period in 2016. The decrease was primarily due to the increase in efficiency resulting from the economies of scale and the implementation of operation systems and optimization of research and product development personnel.

Sales and marketing expenses for the fourth quarter of 2017 were CNY 193.7 million, down 51% year-over-year. Sales and marketing expenses as a percentage of net revenues were 41% in the fourth quarter of 2017, decreasing from 124% as a percentage of non-GAAP net revenues in the corresponding period in 2016. The decrease was primarily due to the decline in brand promotions and the preference for the marketing channels with higher ROI.

General and administrative expenses were CNY 154.5 million in the fourth quarter of 2017, down 25% year-over-year. General and administrative expenses as a percentage of net revenues were 33% in the fourth quarter of 2017, decreasing from the 64% as a percentage of non-GAAP net revenue in the corresponding period in 2016. The decrease was primarily due to the increase in efficiency resulting from the economies of scale and optimization of administrative personnel.

Net loss attributable to ordinary shareholders was CNY 184.9 million in the fourth quarter of 2017. Non-GAAP net loss attributable to ordinary shareholders, which exclude share-based compensation expenses and amortization of acquired intangible assets, was CNY 130.7 million in the fourth quarter of 2017. As of December 31, 2017, the company had cash and cash equivalents, restricted cash and short-term investments of CNY 3.7 billion. Capital expenditures for the fourth quarter of this year were CNY 21 million.

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Now moving to the full year 2017 results. In 2017, net revenues were CNY 2.2 billion, representing 53% year-over-year growth on a non-GAAP basis. Revenue from packaged tours, which are mainly recognized on a net basis, were up 50% year-over-year on a non-GAAP basis to CNY 1.6 billion and accounted for 73% of our total net revenue in 2017. The increase was primarily due to the growth of organized tours and self-guided tours.

Other revenues were up 56% year-over-year on a non-GAAP basis to CNY 602.7 million and accounted for 27% of our total net revenues in 2017. The increase was primarily due to a raise in revenue generated from financial services and commission fees received from certain travel-related products.

Gross profit was up 81% year-over-year on a non-GAAP basis to CNY 1.2 billion in 2017. The increase in gross profit and gross margin was primarily due to the improved economies of scale, increased operational efficiency and optimized supply chain management.

Operating expenses were CNY 2.1 billion in 2017, down 35% year-over-year, excluding share-based compensation and amortization and acquired intangible assets. Non-GAAP operating expenses were CNY 1.8 billion, representing a year-over-year decrease of 38%.

Research and product development expenses were CNY 541.1 million in 2017, down 10% year-over-year. Research and product development expenses as a percentage of net revenues were 25% in 2017, decreasing from 42% as a percentage of non-GAAP net revenues in 2016. The decrease was primarily due to the increase in efficiency resulting from the economies of scale and the implementation of operation system and optimization of research and product development personnel.

Sales and marketing expenses were CNY 894.1 million in 2017, down 53% year-over-year. Sales and marketing expenses as a percentage of net revenues were 41% in 2017, decreasing from 133% as a percentage of non-GAAP net revenues in 2016. The decrease was primarily due to the decline in brand promotions and the preference for marketing channels with higher ROI.

General and administrative expenses were CNY 637.8 million in 2017, down 3% year-over-year. General and administrative expenses as a percentage of net revenues were 28% in 2017, decreasing from the 46% as a percentage of non-GAAP net revenues in 2016. The decrease was primarily due to the increase in efficiency resulting from the economies of scale and optimization of administrative personnel.

Net loss attributable to ordinary shareholders were CNY 773 million in 2017. Non-GAAP net loss attributable to ordinary shareholders, which exclude share-based compensation expense and amortization of acquired intangible assets, was CNY 532.8 million in 2017. Capital expenditures were CNY 156.1 million in 2017. Due to the factors mentioned earlier in the conference, we expect light growth for the next quarter. Tuniu currently expect to generate CNY 469.7 million to CNY 488 million of net revenues for the first quarter of 2018, which represents 3% to 7% year-over-year growth. Please note that this forecast reflects Tuniu's current and preliminary view on the industry and its operations, which is subject to change.

Thank you for listening. We are now ready for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question today come from Chun Choi with 86Research.

Chun Choi - *86Research Limited - Research Analyst*

I have 1. I just want to understand more on the off-line retail store initiative. So 1 of your major competitors has been aggressively rolling out a number of off-line stores as well. So how do you view the competitive landscape? And what are our edges over our peers? And in terms of the selection of the location, how do you strategically select the stores so that you guys won't have face-to-face competition? Yes, that is my question.

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Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Translating for Donald. We are rolling out a number of stores within China, and it is true that a number of our peers also are opening. However, there is a major difference between our models. So first of all, we open our stores and these stores are run directly by Tuniu, while many of our competitors within the industry use the franchise model. So this is a lot different in terms of the customer experience. So with stores that Tuniu opened, we are able to control the quality of our services and to better engage with our customers and to provide the correct products to these customers, whereas the franchise model is much more difficult.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

In terms of -- by running our own stores, we are able to protect one of the key assets to Tuniu, which is our customers. And by using these stores, we could extract the most amount of value from our customers as we are able to give them the best services and products. This allows us to improve the repurchase rate and engage them in a much better level than using a franchise model.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

The general logic that we use in opening our stores is we identify where Tuniu customers are online, and then we are able to find locations where they could be off-line, and then we try to open stores within those areas. So this method is very precise and we're able to clearly identify the locations where we want to open stores. And in terms of the overall balance within China, approximately 80% of customers still book through off-line channels and only 20% book through online channels. So we see this as a large opportunity, and that's 1 of the reasons why we continue to open off-line stores to capture this market. And this year, we are seeing very positive results from our off-line stores. In 2017 as a percentage of our total -- during the fourth quarter of 2017, as a percentage of our total GMV, off-line stores contributed approximately 18% of our total GMV.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

So another benefit of our self-run stores is the dedicated customer service that we are able to provide locally at these stores. Within these locally -- local retail stores, we are able to dedicate specific customer representatives to customers. These people are -- provide very high-quality VIP services to help the customer book their products. And this combines -- and this complements our online customer service. So with this off-line

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customers service, we are able to increase the stickiness of our customer to our platform and, overall, develop our online and off-line customer service experience.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Okay. Our customer service is divided into 2 components. One is the dedicated customer service. This component follows the customer and provides very dedicated overall comprehensive service to this customer, and this complements our online customer service. So we have this model previously -- before, even before we opened our off-line retail stores. However, once we did open the store, we put the dedicated service -- customer service into the local stores. So by having dedicated customer service, we're able to address all of the customer's questions by -- through 1 customer representative instead of having multiple people help out the booking process. So overall, by having 2 types of customer representatives and especially now within the local retail stores, we are seeing a much higher customer repurchase rate. And this could be seen by the amount of repeat customer contribution to our overall GMV during the last quarter.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

And this is the key here. This model is impossible to be executed on for a franchise retail store.

Chun Choi - *86Research Limited - Research Analyst*

(foreign language) follow-up on the -- could management share with regard to -- share some color on the profitability of the off-line store and also the payback period and also the ramp up, the sort of the ramp-up period? How long does it take to generate positive return?

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Okay, thank you for your question. So we started our -- opening our local retail stores during the first half of 2017. So most of our stores have now been opened for -- have now been in operation for over a year. Of the stores that have been opened for more than a year, we are seeing a general positive data. So these stores are able to generally reach profitability within 1 year or 1.5 years. So -- and we are seeing this trend for most of our stores. And the other model that we also use is the single-city model. So we put stores within a single city. So combining these 2 models, we are -- we believe that we're able to quickly and efficiently increase our coverage of China.

Operator

(Operator Instructions) The next questions come from Ivy Ji with Credit Suisse.

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Ivy Ji - *Crédit Suisse AG, Research Division - Research Analyst*

Sir, in the opening remarks, you mentioned that there were some headwinds in certain destinations. So I just wanted to check what's the current contribution -- I mean, GMV contribution by destination and what's your strategy to handle some of the headwinds.

Yi Xin - *Tuniu Corporation - CFO*

During the fourth quarter of 2017, we continued to see the recovery from the Europe since tariff tax earlier in 2016. And in this quarter, as a percentage of GMV, Europe, Southeast Asia and Middle East each contributed approximately 10% of our overall GMV. Japan and South Korea, combined together, contributed about 9% of the total GMV. And other destinations, such as North America, contributed 3% and the cruise line contributed 7%. Since the impacts in some islands in this quarter only contributed 5% because of the volcano in the Bali.

Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

There have been a number of external factors that have influenced some of the demand for travel. This is especially true for Bali and Maldives. But, however, because Tuniu is a highly diversified company, both in terms of product and destination, we believe the impact of these external events will be short term and limited and -- limited. So these external events are pretty common in the travel industry and -- however, we believe that, based on our early booking data, we are seeing -- we are already seeing a very strong recovery starting in the second quarter of 2018. So we -- this recovery mostly concern our -- directing many of our customers to other locations and giving them alternative products and services.

Operator

The next question comes from Tian Hou with T.H. Capital.

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

So the guidance is -- looks weak, so I wonder what's the reason behind it. That's number 1. So in 2018, so there can be some headwinds, and what's the company's strategy in terms of a new product development? So that's number 1 question. Number 2, in terms of our future routes like Southeast Asia and Europe or other places, what can be the focus of Tuniu to continue to develop? So that's my 2 questions.

Yi Xin - *Tuniu Corporation - CFO*

Tian. The guidance, so you know, we have 2 part of the revenue and the packaged tours and as well as the other revenues. So the packaged tours growth rates actually is higher than the blended guidance growth rates even it's impacted by some external events in the Maldives, Bali and some other destinations. So for the other revenues, it's mostly because of the new policy on the insurance bundling because we can't -- we are now don't bundle the insurance with our online tickets, so [twin tickets]. So this is the reason why it impacts our other revenue growth rate. So it's a negative growth in the fourth quarter 2018, so that's lowering our blended growth rate in the fourth quarter.

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

(foreign language)

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Dunde Yu - *Tuniu Corporation - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

In terms of our approach, we are, first, going to emphasize on the destinations that are within close proximity of China. So this includes, primarily, Japan, Southeast Asia. So in Japan and Thailand, we already have our local tour operator. And with those local tour operators, we are able to provide domestic local services to them. So this year, we'll be putting increased emphasis into the -- our Asia expansion. We have -- one of the key difference between Tuniu and many of our peers is that we have the distribution power and we are able to push any destination that we want. And starting this year, we'll primarily do Asia. And going forward, we think Europe and America will also be areas we will put increased emphasis in. We have a number of travelers to those regions. Although the number of trips is relatively lower than those of Asia, the ASP is much higher. So we see the next logical step for us will be to go for Europe and America.

Operator

We are now approaching the end of the conference call. I will now turn the conference over to Tuniu's CFO, Maria Xin, for any closing remarks.

Yi Xin - *Tuniu Corporation - CFO*

Once again, thank you for joining us today. Please don't hesitate to contact us if you have any further questions. Thank you for your continued support, and we look forward to speaking with you in the coming months.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

Yi Xin - *Tuniu Corporation - CFO*

Thank you.

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