



## Company Report: Youku Tudou (YOKU US)

公司报告: 优酷土豆 (YOKU US)

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# NO.2 Chinese Mobile App by User Time Spent, 'BUY'

## 中文App用户时长排名第二, “买入”

- Youku Tudou (Youku)'s 3Q14 results were basically in-line with our expectations.** Revenue was RMB1,107mn, up 29% yoy, below expectations. Non GAAP Net income reached RMB103mn, better than our expectations, 22% higher than market expectations.
- Key points: 1) Youku App ranked the 2<sup>nd</sup> in Chinese App by user time spent.** According to iResearch, Youku App has surpassed mobile QQ app by user time spent in 11M14. Currently, Youku App and mobile QQ MAU reached around 130mn and more than 520mn, respectively, which means that there is still upside room for Youku App. **2) Cooperate with Alibaba Group and Xiaomi.** Youku is cooperating with Alibaba Group in big data, ecommerce, and online payment. Youku and Xiaomi have built up strategic partnership. **3) Youku has leading position in mobile TV drama and UGC video streaming.** According to our research, Youku App has created far more traffic in TV drama than iQiyi App in 2H14. We think Youku App's biggest competitor might be Tencent video, not iQiyi video, in the future.
- Maintain Target Price at USD32.00 and 'BUY' investment rating.** We think Youku App mobile video user time spent is increasing quickly, boosting monetization expectation in the future. Our FY14-16 earnings per ADR estimates are RMB3.116, RMB0.393, and RMB4.256, respectively. Our TP is USD32.00, representing 2.7x 2015E PB.
- 优酷土豆 (优酷) 3Q14 业绩基本符合我们预期。** 收入为 RMB1,107 百万, 同比增 29.0%, 略低于预期。Non-GAAP 净利润达到 RMB103 百万, 好于我们预期, 较市场预期高约 22%。
- 要点: 1) 优酷 App 移动端用户时长排名中文 App 第二。** 根据艾瑞统计, 优酷 App 用户时长在 11 月初超过手机 QQ, 排名中文 App 第二。目前优酷 App 和手机 QQ 移动 MAU 分别是 1.3 亿左右和 5.2 亿以上, 意味着优酷 App 用户时长增长仍然有很大空间。**2) 与阿里巴巴及小米合作。** 优酷与阿里巴巴集团在大数据、电商和支付领域逐步展开合作。优酷和小米签署了战略合作协议。**3) 目前优酷在电视剧和 UGC 流量处于领先地位。** 根据我们统计, 在 2H14 优酷 App 在电视剧流量上大幅领先于爱奇艺 App。优酷未来最大的竞争对手可能已经不是爱奇艺, 而是腾讯视频。
- 目标价维持 USD32.00, 投资评级维持“买入”。** 2014 年, 我们认为目前优酷 App 移动端的用户时长增长非常强劲, 未来货币化可能加快。我们 FY14-16 年的每股 ADR 预测是 RMB3.116、RMB0.393 和 RMB4.256。目标价 32.00 美元, 相当于 2.7 倍的 2015 年预测市净率。

Rating:

Buy

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

US\$32.00

Revised from 原目标价:

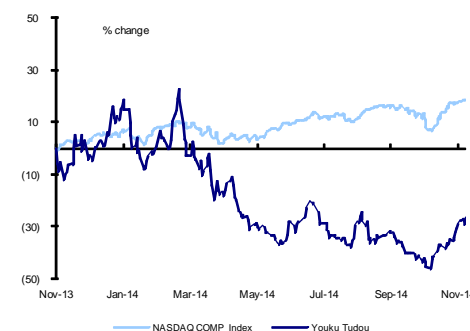
US\$32.00

Share price 股价:

US\$22.020

## Stock performance

股价表现



Change in ADR Price ADR 变动	1 M 1 个月	3 M 3 个月	1 Y 1 年
Abs. % 绝对变动 %	25.8	1.0	(24.8)
Rel. % to NASDAQ index 相对纳指变动 %	17.7	(3.4)	(38.3)
Avg. ADR price(US\$) 平均 ADR 价 (美元)	20.5	20.8	26.0

Source: Bloomberg, Guotai Junan International.

Year End 年结 12/31	Turnover 收入 (RMB m)	Net Profit 股东净利 (RMB m)	Earnings /ADR 每 ADS 净利 (RMB)	Earnings /ADR 每 ADS 净利变动 (%)	PER 市盈率 (x)	BV/ADR 每 ADS 净资产 (RMB)	PBR 市净率 (x)	DP/ADR 每股股息 (RMB)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2012A	1,796	(424)	(3.200)	106.5	n.a.	70.527	1.9	0.000	0.0	(6.3)
2013A	3,028	(581)	(3.501)	9.4	n.a.	54.147	2.5	0.000	0.0	(6.3)
2014F	4,000	(607)	(3.116)	(11.0)	n.a.	73.074	1.9	0.000	0.0	(5.2)
2015F	5,641	79	0.393	(112.6)	n.a.	73.610	1.9	0.000	0.0	0.5
2016F	8,066	880	4.256	n.a.	32.1	77.987	1.8	0.000	0.0	5.7

ADR in issue (m) 总股数 (m)	194.2	Major shareholder 大股东	Victor Koo 18.3%
Market cap. (US\$ m) 市值 (US\$ m)	4,792.2	Free float (%) 自由流通比率 (%)	17.5
3 month average vol. 3 个月平均成交股数 ('000)	2,921.2	FY14 Net gearing FY14 净负债/股东资金 (%)	Net cash
52 Weeks high/low (US\$) 52 周高/低	37.740 / 15.910	FY14-16 PEG FY14-16 市盈率相对盈利增长比率	n.a.

Source: the Company, Guotai Junan International.

**Youku Tudou (Youku)'s 3Q14 results were basically in-line with our expectations.** Revenue was RMB1,107mn, up 29% yoy, below expectations. Ad revenue reached RMB985.2mn, up 32% yoy. Consumer revenue reached RMB41.8mn, up 473% yoy, including subscription revenue and pay-as-view orders. Youku has hired Teddy, a former product manager from Tencent (700 HK), as Chief Product Officer, to improve Youku's membership management. Content costs reached RMB501.8mn, up only 1% yoy, accounting for only 45% of net revenues, down 13ppt yoy. As a result, its non GAAP Net income reached RMB-103mn, better than our expectations, 22% higher than market expectations. In 4Q14, we expect Youku revenue could improve a lot due to peak season of ecommerce.

**Table 1: Youku's 3Q14 Results**

Report	Our Expectations	Result		
Net Revenues	1,175	1,107	-5.8%	Revenue below expectations, expected to accelerate in 4Q14 and 2015.
Cost of Revenues	(980)	(860)	-12.3%	Content cost was below expectations
Gross profit	195	247	26.8%	
Sales and Marketing	(247)	(287)	16.3%	
General and Administrative	(91)	(53)	-41.9%	
Product Development	(121)	(112)	-7.5%	
Operating Income	(265)	(206)	-22.4%	
net finance cost	20	23	14.4%	
Other Income (Loss), Net	0	2		
Earnings before Taxes	(245)	(181)	-26.0%	
Provision for Income Tax	0	0		
Net Income (Loss)	(245)	(181)	-26.0%	Better than expectations
Non-GAAP net loss (Profit)	(133)	(103)	-22.8%	Better than expectations

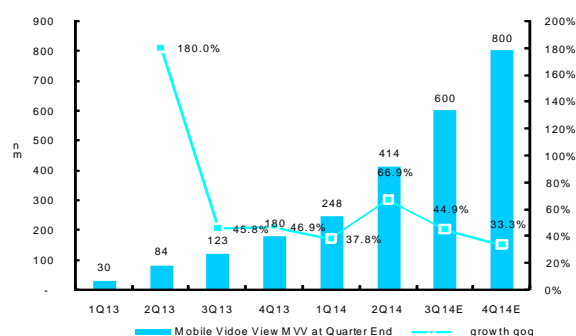
Source: the Company, Guotai Junan International.

**Table 2: Assumption Revision**

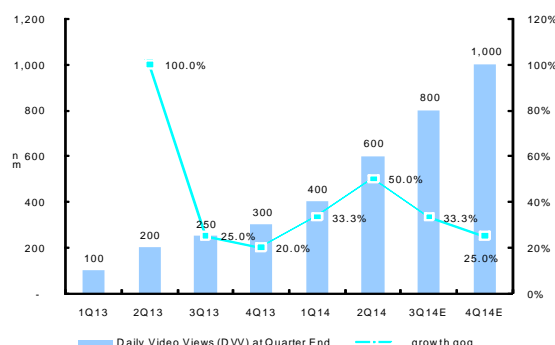
Income Statement mn RMB	FY14			FY15			FY16		
	OLD	NEW	Change%	OLD	NEW	Change%	OLD	NEW	Change%
Net Revenues	4,069	4,000	-1.7%	5,737	5,641	-1.7%	8,204	8,066	-1.7%
Cost of Revenues	(3,158)	(3,037)	-3.8%	(3,916)	(3,756)	-4.1%	(4,807)	(4,598)	-4.3%
Gross profit	911	963	5.7%	1,822	1,884	3.4%	3,398	3,468	2.1%
Sales and Marketing	(905)	(946)	4.4%	(1,205)	(1,185)	-1.7%	(1,641)	(1,613)	-1.7%
General and Administrative	(308)	(270)	-12.4%	(344)	(338)	-1.7%	(476)	(468)	-1.7%
Product Development	(429)	(420)	-2.1%	(430)	(423)	-1.7%	(574)	(565)	-1.7%
Operating Income	(732)	(672)	-8.1%	(158)	(62)	-60.9%	707	823	16.4%
net finance cost	61	61	0.1%	139	141	1.1%	152	155	2.3%
Other Income (Loss), Net	1	4	262.2%	0	0		0	0	
Earnings before Taxes	(670)	(607)	-9.3%	(19)	79	-560.2%	859	978	14.7%
Provision for Income Tax	(0)	(0)	0.0%	0	0		(86)	(98)	14.7%
Net Income (Loss)	(670)	(607)	-9.3%	(19)	79	-560.2%	773	880	14.7%
Non-GAAP net loss (Profit)	(284)	(255)	-16.5%	329	422	28.4%	1,241	1,341	8.0%

Source: the Company, Guotai Junan International.

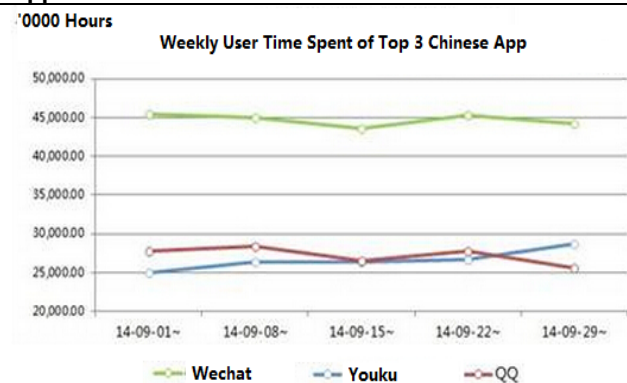
**Youku App ranked the 2<sup>nd</sup> in Chinese App by user time spent.** According to iResearch, Youku App has surpassed mobile QQ app by user time spent in 11M14. Currently, Monthly Active User (MAU) of Youku App and mobile QQ reached around 130mn and more than 520mn, respectively, which means that there are still upside room for Youku App. According to Youku, total MAU including Youku and Tudou reached around 500mn. Average Daily Video Views (DVVs) across all screens reached 700mn in 3Q14, compared to 560mn in 2Q14. We think DVVs should surpass 800mn in 9M14, as we expected, and might reach around 1,000mn in 12M14. Youku App's user time spent has surpassed the sum of the 2<sup>nd</sup> and 3<sup>rd</sup> video app in 3Q14. **Youku App has exhibited great growth potential in 3Q14.**

**Figure 1: Youku's Mobile Daily Video Views**


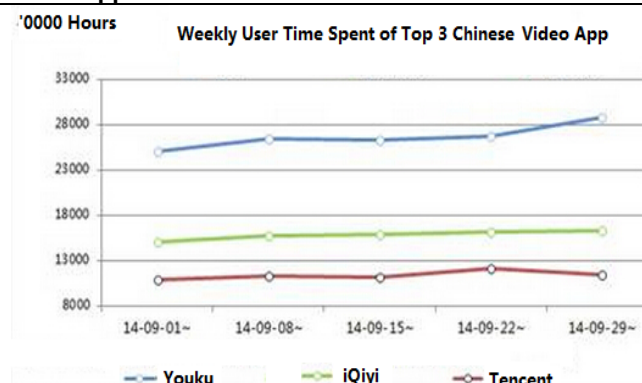
Source: the Company, Guotai Junan International.

**Figure 2: Youku App's Daily Video Views**


Source: the Company, Guotai Junan International.

**Figure 3: Weekly User Time Spent of Top 3 Chinese Apps**


Source: iResearch, Guotai Junan International.

**Figure 4: Weekly User Time Spent of Top 3 Chinese Video Apps**


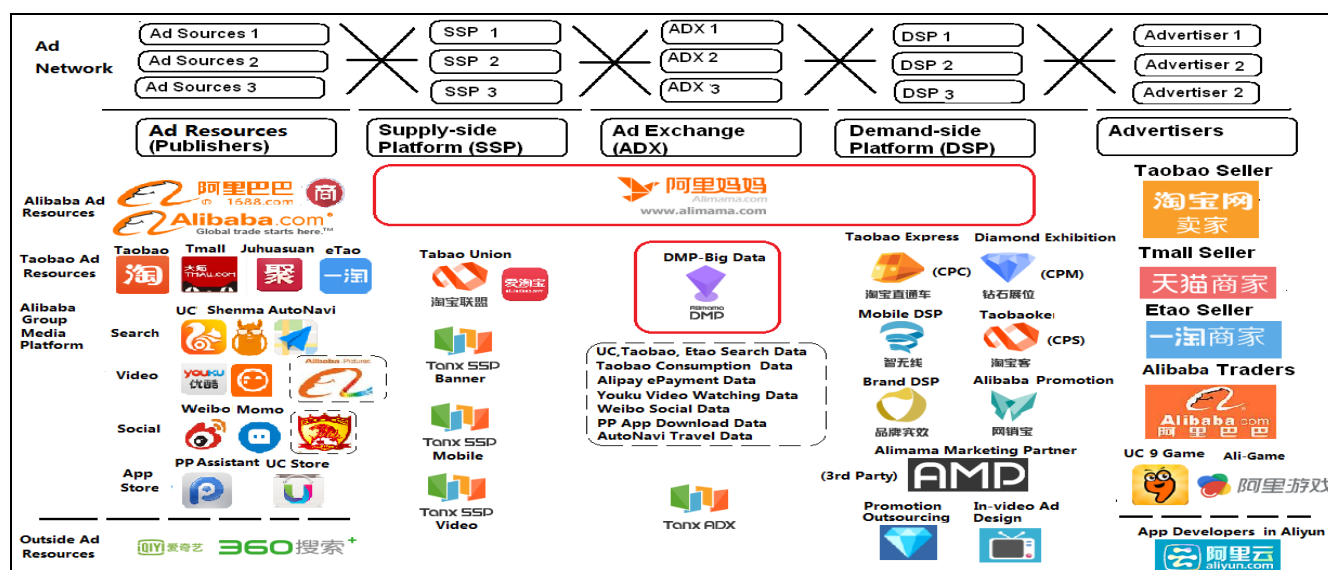
Source: iResearch, Guotai Junan International.

**Cooperate with Alibaba Group.** Youku is cooperating with Alibaba Group in big data, ecommerce, and online payment. We expect Youku membership and Tmall VIP to have deeper cooperation in the future. In 11M14, Youku and Alimama have announced new cooperation together. We have several views: **1) Big data cooperation with Alimama video and mobile platform is urgent.** Currently, Youku App has very strong mobile traffic and Youku needs to monetize the mobile traffic without hurting audiences' video watching experiences, which needs more precision marketing through user big data. Alimama has recorded lots of user consumption data and ad effect data (CPM, CPC, and CPS), to improve ad effect. Alimama's Data Management Platform (DMP) is a powerful ad exchange center with all kinds of users' online behavior data in Alibaba Group and Ant Financial Group, including consumption data, payment data, social media data, and commodity search data. We think video shopping is still at the early stage and it might take 1~2 years to create effective mode. **2) Youku should build deep traffic exchange with Taobao, Alipay, and Weibo (WB US).** Currently, Taobao has mobile MAU of 217mn in 3Q14 and Alipay has mobile MAU of 200mn in 3Q14. Weibo has mobile MAU of around 120mn. We think Youku should consider to build more frequent traffic exchange with Taobao, Alipay, and Weibo. Like Amazon (AMZN US), its Amazon Prime subscribers could get several months of free subscription in Amazon Instant Video service. In the future, one effective way would be to build up membership connections among Taobao, Weibo, and Youku.

**Xiaomi signed strategic partnership agreement with Youku.** Currently, Xiaomi has 85 million active MIUI users and has built a sub-culture Xiaomi community, consisting of young users with moderate level of education. Xiaomi and Youku might have deep cooperation in smartphones, tablets, smart TV, and PGC content. Xiaomi prepared to invest USD1.0bn in building Xiaomi's own content. Xiaomi is paying great attention to build their own corporate culture inside the company and also with MIUI fans. In 2012, Xiaomi's 7 co-founders have made a Micro movie named *Our 150g Youth* (我们的150g青春) to tell their MIUI fans about their campus life, to create resonance with their MIUI fans. We think Youku and Xiaomi could create special PGC content to their audiences. Secondly, Youku might provide more content library support to Xiaomi smartphone and smart TV. Youku has invested in Guoguang Dongfang (国广东方), which has China International Broadcasting Network (CIBN)'s OTT licenses. Youku and Guoguang Dongfang (国广东方)'s TV OS has already been approved by SARFT. And Xiaomi TV

could use their TV OS and video content immediately.

**Table 3: Alibaba Group's Alimama Ad Network**



Source: the Company, Guotai Junan International.

**Youku had weak TV drama traffic in 1H14.** According to our research, Youku App has created far more traffic in TV drama than iQiyi App in 2H14. We have made detailed traffic statistics about major TV drama (TV drama series traffic above 10mn) traffic across Youku, iQiyi, and Tencent video. In Jul 10<sup>th</sup> 2014, we have made traffic statistics of new TV drama, which released between Jan 1<sup>st</sup> and Jun 31<sup>st</sup> 2014. We could see that Youku has 10,413mn VVs and 7,068mn VVs, far behind iQiyi's VVs of 15,744mn and mobile VVs of 9,153mn. Youku's mobile TV drama traffic in 1H14 was 8% less than that of iQiyi. The main reason was that iQiyi has bought 2 hot TV dramas: *iApartment 4* and *You from the Stars*, which created over 5.0bn traffic in 1H14.

**Youku has shown great improvement in TV drama traffic in 2H14.** We have made major TV drama statistics (TV drama series with VVs above 10mn) released from Jul 1<sup>st</sup> 2014 and Nov 10<sup>th</sup> 2014. In China TV drama traffic, Youku, iQiyi and Tencent have created 7,149.0mn, 7,271.1mn and 10,513.8mn, as iQiyi and Tencent have bought more China TV dramas. Tencent have bought nearly all the hot China TV dramas in 2H14. In all the TV drama traffic, Youku, iQiyi, and Tencent have created 13,564.7mn, 7,809.9mn, and 11,391.9mn VVs, respectively. In mobile TV drama traffic, Youku and iQiyi have 9,433.2mn and 5,419.5mn traffic. Youku's mobile TV drama traffic in 2H14 was 74% higher than that in iQiyi. Tencent video didn't release its mobile traffic data. Youku have far more traffic in TVB, Korea TV drama and in-house mini TV dramas. TVB has created 3.4bn VVs, nearly doubled compared to that in 1H14. Its Line Walker has created around 2.0bn traffic. In in-house mini TV drama, Youku's top mini TV drama brand Unbelievable Season 2 has created 670mn traffic, NO.1 in in-house mini TV drama in China in 2014. Youku has signed strategic partnership agreement with Korea SBS and OCN TV stations. Korea SBS TV station created popular Modern Romance genre TV dramas, while OCN TV station is good at creating Crime genre TV dramas. Youku have bought exclusive online air copy rights of SBS and OCN TV dramas in China. Obviously, Youku has created great content differentiation in in-house mini TV dramas, TVB TV dramas, and Korea TV dramas.

**Table 4: Major TV Drama Traffic Comparison (New TV Drama Released between Jan 1st in 2014 till Jul 10th, with traffic statistic date at Jul 10th)**

TV Dramas by Type	Youku		iQiyi	
	Total VVs	mn	Total VVs	mn
TVB TV Drama	1,924	1,313		
US TV Drama	172	82	120	72
China TV Drama	8,804	6,035	11,513	6,614
In-house Mini TV Drama	385	222	1,111	667
Korea TV Drama	1,052	730	3,000	1,800
Total	12,337	8,381	15,744	9,153

Source: iResearch 6M14, Guotai Junan International.

**Table 5: China Major TV Drama Traffic Comparison (New TV Drama Released between Jul 1<sup>st</sup> in 2014 till Nov 14<sup>th</sup>, with traffic statistic date at Nov 14<sup>th</sup>)**

China TV drama		First Air	Video Views mn			Mobile Videw Percentage	
			Youku	iQiyi	Tencent	Youku	iQiyi
Swords of Legends	古剑奇谈	2014/7/3		2,203.0		1,840.0	70.8%
My Youth High Eight Degrees	我的青春高八度	2014/7/6		97.8	48.1		26.2%
Sunshine In Me	骄阳似我 TV 版	2014/7/18		128.7			36.3%
The Love is Inconceivable	爱情最美丽	2014/7/21		134.7	40.0	139.8	55.0%
Love is Back	爱情回来了	2014/7/22		445.7	329.0	396.0	80.2%
Quarrelsome Lovers	当婆婆遇上妈之欢喜冤家	2014/8/5		69.8	71.0	59.9	75.0%
Our Second Child	二胎	2014/8/6		54.5	70.3	52.0	76.0%
Dating Hunter	约会专家	2014/8/6		267.4		176.0	69.2%
Happiness Comes to You	假如幸福来临	2014/8/6		28.8	35.3	56.8	71.4%
New Mad-Monk	新济公活佛	2014/8/21		297.5	417.0	728.6	76.5%
The Virtuous Queen of Han	卫子夫	2014/8/21		557.1		692.5	84.4%
Xie Wendong S1	谢文东	2014/8/26		83.8		82.0	80.6%
Xie Wendong S2	谢文东 第二季	2014/8/26		53.3		72.7	79.6%
Fire Sky	战火连天	2014/9/1		54.9		92.3	74.8%
The Moon Of Gulf Of Aden	舰在亚丁湾	2014/9/3		46.2	26.8	28.6	75.5%
The New Snow Leopard	雪豹坚强岁月	2014/9/4		219.4	174.0	294.3	78.0%
The Sharp knife	铁血尖刀	2014/9/5		77.1	47.4	60.6	78.1%
Marriage Cuisine	婚姻料理	2014/9/8		90.5	38.5	97.5	71.9%
My Battalion	我的特一营 TV 版	2014/9/10		228.3	285.1	326.3	77.9%
Ma Xiangyang	马向阳下乡记	2014/9/18		215.5	234.0	434.6	74.8%
Good Wife 101	幸福 36 计	2014/9/19		121.6	91.6	284.0	81.5%
The Loving Home	把爱带回家 TV 版	2014/9/22		351.4	275.0	363.8	79.4%
menfolk	爷们儿	2014/9/24		156.8	126.0	199.2	73.4%
The Extremely Danger	势不两立	2014/9/23		43.3	38.0	54.3	77.0%
Love's Relativity	恋爱相对论	2014/9/27		111.5	48.3	65.9	83.5%
Negotiations Sweetheart	谈判冤家	2014/10/1		83.7	50.8	98.0	79.2%
The Red	红色	2014/10/6		12.9	27.2	14.7	70.2%
The Predator Soldiers	铁血武工队传奇	2014/10/7		148.9	115.0	135.2	79.1%
Brothers	兄弟兄弟	2014/10/8		30.2	51.2	48.0	64.6%
Error Marriage	错婚	2014/10/16		33.2	33.6	28.3	63.5%
Cross Fire	穿越火线 TV 版	2014/10/18		54.4	68.7	82.6	72.6%
Because of Love,Love is a Miracle	因为爱情	2014/10/21		244.2	294.7	94.3	82.7%
Marry Him Or Not	不是不想嫁	2014/10/21		76.9	47.5	45.5	69.7%
The King of Guns	绝地枪王	2014/10/26		235.4	189.0	168.8	57.8%
Awakened	觉醒者	2014/10/26		12.2	26.7	30.5	48.1%
Foster Father's Blossom Age	养父的花样年华	2014/10/30		19.6	24.6	20.8	72.4%
Little Mom	大都市小爱情	2014/11/2		37.2	36.7	56.7	77.9%
Cheetah Assault	我的抗战之猎豹突击	2014/11/4		19.8	25.6	26.7	69.8%
Big Steward	当家大掌柜	2014/9/20		1.8	10.4	5.8	53.3%
Shanshan Is Coming	杉杉来了	2014/7/8			944.0		73.0%
Brave Heart	勇敢的心	2014-08-21			680.0	843.0	59.0%
Bodyguard of Love	爱的保镖	2014/8/30			22.8	33.9	55.0%
Rape Flower Flavour	油菜花香	2014/9/13			18.9	32.6	54.0%
Gods of War	战神	2014/9/18			766.0	168.9	52.0%
Color of The Wind	风中奇缘	2014/10/1			526.2	523.7	75.0%
Peaceful Beijing	北平无战事	2014/10/6			211.0	157.6	65.0%
Halfway Father and Son	半路父子	2014/10/13			104.0	180.0	73.0%
My Brothers	我和我的他们	2014/10/27			20.1		76.0%
Red Sorghum	红高粱	2014/10/27			581.0	668.7	66.0%
Swordsman	剑侠	2014/10/21			452.0		
Total				7,149.0	7,271.1	10,513.8	73.2%
							66.0%

Source: iResearch 6M14, Guotai Junan International.



**Table 6: Other TV Drama Traffic Comparison (New TV Drama Released between Jul 1<sup>st</sup> in 2014 till Nov 14<sup>th</sup> 2014, with traffic statistic date at Nov 14<sup>th</sup>)**

Youku		VVs mn	iQiyi		VVs mn	Tencent	VVs mn
<b>TVB</b>							
Ghost Dragon of Cold Mountain	寒山潜龙	416.6					
Black Heart White Soul	忠奸人	586.9					
Shades of Life	我们的天空	8.6					
Line Walker	使徒行者	1,694.5					
All That is Bitter is Sweet	大药坊	270.9					
Tomorrow Is Another Day	再战明天	295.8					
Tiger Cubs II	飞虎 II	213.0					
Come on, Cousin	老表，你好 Hea!	86.9					
Over achievers	名门暗战	73.0					
		3,646.2					
<b>Korea TV drama</b>							
Endless Love	无尽的爱	10.8	Iron Man	钢铁人	40.0	Secret of Sweet	甜蜜的秘密 1.6
Marriage Not Dating	不是恋爱，是结婚	176.6	Pride and Prejudice	傲慢与偏见	8.8	High School Love On	High School Love On 164.0
Lure	诱惑	177.3	Legend Magic Girl	传说的魔女	9.8	Family Struggles	家族之间何必这样 26.4
It doesn't matter, this is love	没关系，这是爱情	269.8	Rose Lovers	玫瑰色的恋人们	6.0	Love Discovery	恋爱的发现 60.0
Mermaid Princess	剩余公主	132.3	Spring of My Life	我人生的春天	11.6		
My Secret Hotel	我的秘密饭店	53.8	Mama	妈妈	18.1		
Three Musketeers	三剑客	22.4	Tomorrow is Song	明日如歌	7.8		
For me, the lovely her	对我而言，可爱的她	318.2	Mr.White	白先生	3.4		
Bad Boys	坏小子们	56.3					
Modern Farmer	摩登农夫	23.6					
Birth of Beauty	美女的诞生	30.2					
		1,271.3			105.4		252.0
<b>In-house Mini TV Drama</b>							
Unbelievable S2	万万没想到 第二季	670.6	Cohabiting Couples	同居损友	24.3	Weird Coffe	怪咖啡 207.7
Tiny Times 1.0	小时代 1.0 折纸时代	508.3	The Heirs from the Star	来自星星的继承者们	82.6	Micro Era	微时代 360.0
Super Soccer	球爱酒吧	173.9	The 7 Muskmelon Brother S2	香瓜七兄弟 2	29.2	First Love Club	初恋女友俱乐部 10.0
Top Rumor	头号绯闻	33.5	Hello! Aliens	你好外星人	125.0	Hold Love	hold 住爱情 10.0
Limbo Biography	冷宫传	29.0	Unbelievable Summer	不可思议的夏天	60.5		
			White Beauty and Long Leg Boys	白衣校花与大长腿	90.4		
		1,415.3			412.1		587.7
<b>US TV Drama</b>							
The Flash Season 1	闪电侠 第一季	42.9	The Flash Season 1	闪电侠 第一季	11.2	The Flash Season 1	闪电侠 第一季 22.6
Agents of S.H.I.E.L.D. Season 2	神盾局特工 第二季	40.0	Agents of S.H.I.E.L.D. Season 2	神盾局特工 第二季	10.1	Agents of S.H.I.E.L.D. Season 2	神盾局特工 第二季 15.8
		82.9			21.3		38.4
Subtotal		6,415.7			538.8		878.1
Total TV Drama Traffic		13,564.7			7,809.9		11,391.9
Total Mobile TV Drama Traffic		9,433.2			5,419.5		n.a.

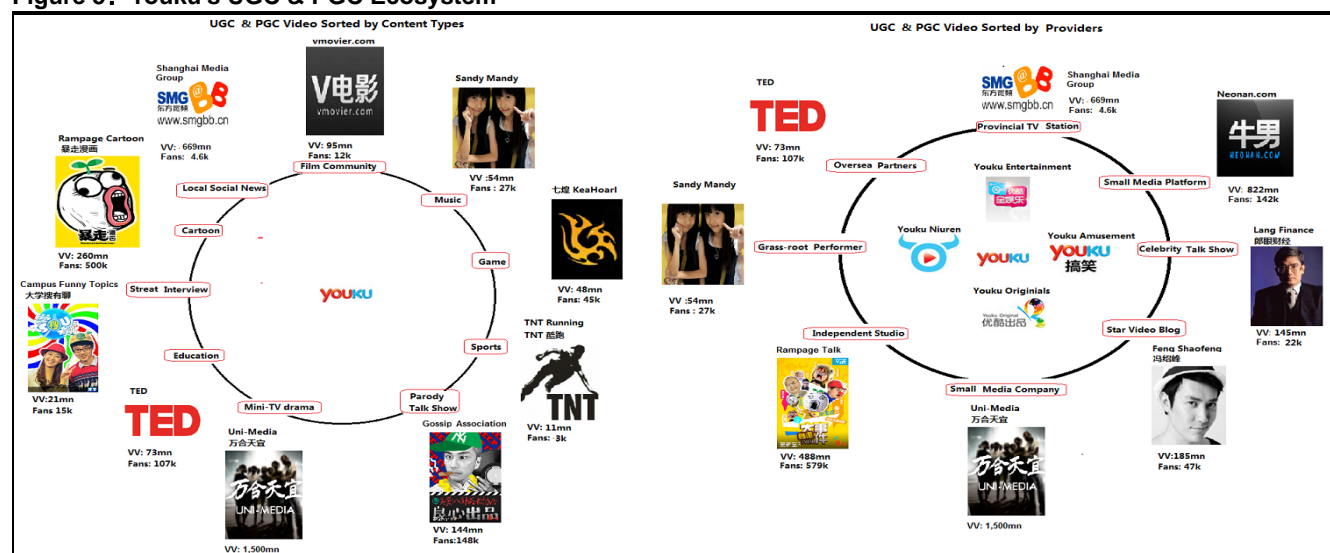
Source: iResearch 6M14, Guotai Junan International.

**Tencent video might create more threats to Youku-Tudou than Baidu's iQiyi and PPS in the long run. First, we think iQiyi and PPS traffic growth might be weakened by its strategy change.** In 2013, iQiyi and PPS tried to build its big variety show platform though Hunan TV variety shows and Korea SBS TV variety shows. However, this strategy might fail in 2015, as Hunan TV wouldn't sell its TV variety show online air copy rights any more and Korea SBS has built up strategic partnership with Youku. The quality of its in-house content was lower than that of Youku and Tencent. We think Baidu's video search could not create much effective traffic, as the long video market has formed a monopoly structure and users tend to upload more videos in Youku. PPS's UGC content library was very old with low definition and might be less competitive in the future. **Second, Tencent could create synergy among video, social media and online games.** Tencent has spent a lot in buying variety shows from Canxing Production, sports video, and China TV dramas. Tencent has great motivation to expand its video platform as video could create synergy to its social media and online games. Sports and singing videos could create traffic to its sports and dancing games. While short videos need to be shared in social media, Wechat has controlled the largest short video flow channel. **Third, Youku still has created great content differentiation with iQiyi and Tencent.** We think at current stage, Youku could achieve its content differentiation through TVB TV drama, Korea TV drama and in-house mini TV dramas. In the long run, Youku's PGC & UGC ecosystem might create more differentiation and it's almost impossible to be replicated.

**Youku has a perfect PGC & UGC Ecosystem, very similar to Youtube.** We have observed that Youku has created a complete PGC & UGC ecosystem, far better than that of iQiyi and Tencent. **There are several points: 1) Youku has built up a very explicit revenue sharing policy with PGC & UGC producers.** Youku would share 30% of ad revenue and 70% of virtual present revenue with PGC & UGC content producers. This policy has created very strong drivers to individuals and small media companies. Furthermore, Youku has already created many in-house contents with UGC & PGC producers, to

help them to create higher quality content. **2) Youku's PGC & UGC ecosystem has diversified producers.** There are 8 kinds of producers: Provincial TV stations, Small Media Platform, Celebrity Talk Show, Star Video Blog, Small Media Companies, Independent Studios, Grass-root Performers, and Oversea partners. Provincial TV stations could publish local news video through Youku. Small Media Platforms usually don't have very robust traffic, especially in mobile devices. They could let Youku to host their videos to save IT spending and could focus on creating high quality content. Both celebrity and stars could extent their exposure through talk shows and video blogs. Small media, individual studios, and grass-root performers could create high quality video as both video shooting and post-production become much easier now due to smartphones and After-Effects softwares. Currently, Youku has cooperated with several overseas video players, including TED and Maker Studios under Disney Group. Maker Studios have managed 550k individual channels under Youtue and could bring more high quality overseas UGC video to Youku. **3) Youku's PGC & UGC ecosystem has diversified content types.** Entertainment news and film community could create synergy with Youku's TV drama and film channels. The parody talk show channels are the most famous channels and create robust traffic in Youku, including Rampage Cartoon, Gossip Maker, and Flying Saucer. There also lots of campus street interview shows, as many young video makers came from campus. **4) Youku has made active content management through its own channels.** Youku chooses hot UGC videos through Youku Niuren, Youku Amusement, Youku Originals, and Youku Entertainment to exhibit them to users.

Figure 5: Youku's UGC & PGC Ecosystem



Source: the Companies, Guotai Junan International.

**Maintain Target Price at USD32.00 and 'BUY' investment rating.** We think Youku App's mobile video user time spent is increasing fast, boosting monetization expectation in the future. Our FY14-16 earnings per ADR estimates are RMB-3.116, RMB0.393, and RMB4.256, respectively. Our TP is USD32.00, representing 2.7x 2015E PB.

Table 7: Peers Comparison

	Stock Code	Currency	Last price	Market Cap		Adjusted PE					GAAP PE				
				mn RMB	12A	13A	14F	15F	16F		12A	13A	14F	15F	16F
Netflix Inc	NFLX US	USD	386.04	180,341.1	319.3	173.8	86.4	64.4	38.3	14,847.7	211.6	112.2	81.0	49.8	
Leshi Internet	300104 CH	CNY	33.51	35,643.2	n.a.	n.a.	n.a.	n.a.	n.a.	72.8	96.0	72.4	47.0	34.5	
Youku Tudou Inc-Adr	Yoku US	USD	22.02	35,563.4	n.a.	n.a.	n.a.	n.a.	50.2	n.a.	n.a.	n.a.	n.a.	70.7	
Yy Inc-Adr	YY US	USD	76.70	33,243.1	50.5	37.6	27.9	19.9	13.6	156.5	67.8	31.2	22.1	14.8	
Phoenix New Media	FENG US	USD	9.79	5,847.8	17.1	16.2	14.4	11.5	8.7	50.7	18.4	16.3	13.2	10.3	
Simple Average					129.0	75.9	42.9	32.0	27.7	3,781.9	98.5	58.0	40.8	36.0	
Weighted Average					204.2	112.4	57.1	42.5	31.7	9,240.8	151.2	82.4	58.8	45.7	
Company	Revenue (mn RMB)				PB					PS (Price to Sales)					
	13A	14F	15F	16F	12A	13A	14F	15F	16F	12A	13A	14F	15F	16F	
Netflix Inc	3,609	4,375	5,505	6,759	6.9	16.5	27.6	33.5	42.4	1.4	4.9	4.2	3.4	2.9	

Leshi Internet	1,122	2,165	6,462	9,774	6.3	2.2	3.3	3.9	n.a.	7.0	13.0	4.4	2.9	2.2
Youku Tudou Inc-Adr	1,796	3,028	3,974	5,512	2.0	3.4	6.2	4.4	3.1	8.4	10.0	7.1	5.1	3.8
Yy Inc-Adr	806	1,839	3,635	5,361	3.7	8.9	8.3	12.4	18.2	3.3	9.4	7.3	5.0	3.6
Phoenix New Media	1,111	1,424	1,656	2,027	3.5	2.8	2.6	2.2	1.8	1.6	3.1	2.8	2.3	1.9
Simple Average					4.5	6.8	9.6	11.3	16.4	4.3	8.1	5.2	3.7	2.9
Weighted Average					5.8	12.0	19.3	23.3	28.8	3.2	7.0	4.9	3.7	3.0

Source: Bloomberg, Guotai Junan International, Aug 13<sup>th</sup> 2014.

**Table 8: Quarterly Results Estimates of Youku**

	1Q14	2Q14	3Q14	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
<b>Revenues</b>												
Net Revenues	700	959	1,107	1,235	988	1,352	1,560	1,741	1,412	1,933	2,231	2,490
Cost of Revenues	(615)	(750)	(860)	(812)	(756)	(928)	(1,225)	(1,007)	(920)	(1,135)	(1,517)	(1,234)
Gross profit	86	209	247	422	231	424	335	735	492	798	714	1,255
Sales and Marketing	(187)	(213)	(287)	(259)	(207)	(284)	(328)	(366)	(282)	(387)	(446)	(498)
General and Administrative	(47)	(74)	(53)	(96)	(59)	(81)	(94)	(104)	(82)	(112)	(129)	(144)
Product Development	(81)	(99)	(112)	(128)	(74)	(101)	(117)	(131)	(99)	(135)	(156)	(174)
Operating Income	(228)	(178)	(206)	(60)	(109)	(42)	(203)	134	29	164	(18)	439
Net finance cost	6	10	23	23	28	32	37	43	30	35	40	46
Other Income (Loss), Net	(2)	3	2	2	2	2	2	2	2	2	2	2
Earnings before Taxes	(225)	(164)	(181)	(36)	(80)	(8)	(165)	178	61	200	24	487
Provision for Income Tax	0	(0)	0	0	0	0	0	0	(6)	(20)	(2)	(49)
Net Income (Loss)	(225)	(164)	(181)	(36)	(80)	(8)	(165)	178	55	180	22	438
<b>Non-GAAP results</b>												
Net loss per ADS, basic and diluted RMB/ADS	(1.338)	(0.882)	(0.877)	(0.185)	(0.460)	(0.043)	(0.794)	0.889	0.309	0.912	0.102	2.120
Non-GAAP (net loss)/ Profit per ADS RMB/ADS	(0.883)	(0.407)	(0.496)	0.375	(0.114)	0.379	(0.314)	1.395	0.763	1.465	0.728	2.783
ADS used in computation, basic and diluted mn shares	168	186	206	195	173	192	207	201	178	198	214	207
<b>Cost of revenue breakdown</b>												
Value added, business taxes and surcharges	63	90	98	101	80	114	125	128	100	142	156	160
Bandwidth costs	202	214	211	207	228	241	238	234	251	265	262	258
Depreciation of servers and other equipment	24	29	26	44	28	33	30	51	31	37	34	57
Content costs	326	418	645	460	420	540	833	593	538	691	1,066	759
Non-GAAP gross profit	103	224	261	439	243	439	358	751	507	817	744	1,277
Non-GAAP operating profit	(152)	(89)	(127)	49	(49)	39	(104)	235	110	273	116	576
Non-GAAP net profit	(148)	(76)	(103)	73	(20)	73	(65)	280	136	290	156	576
Stock-Based compensation	70	82	72	102	57	77	93	97	76	104	126	130
<b>Key growth rate YoY %</b>												
Net revenues	36%	27%	29%	37%	41%	41%	41%	41%	43%	43%	43%	43%
Cost of revenue	23%	33%	26%	26%	23%	24%	25%	24%	22%	22%	24%	23%
Value added, business taxes and surcharges	29%	20%	30%	30%	27%	27%	27%	27%	25%	25%	25%	25%
Bandwidth costs	25%	30%	16%	16%	13%	13%	13%	13%	10%	10%	10%	10%
Depreciation of servers and other equipment	8%	34%	20%	20%	15%	15%	15%	15%	12%	12%	12%	12%
Content costs	21%	38%	30%	30%	29%	29%	29%	29%	28%	28%	28%	28%
Sales and Marketing	27%	22%	21%	21%	21%	21%	21%	21%	20%	20%	20%	20%
General and Administrative	7%	8%	8%	8%	6%	6%	6%	6%	6%	6%	6%	6%
Product Development	12%	10%	10%	10%	8%	8%	8%	8%	7%	7%	7%	7%
<b>Margin %</b>												
Gross margin	12%	22%	22%	34%	23%	31%	21%	42%	35%	41%	32%	50%
Operating margin	-33%	-19%	-19%	-5%	-11%	-3%	-13%	8%	2%	8%	-1%	18%
Net margin	-32%	-17%	-16%	-3%	-8%	-1%	-11%	10%	4%	9%	1%	18%
Non-GAAP gross margin	15%	23%	24%	36%	25%	32%	23%	43%	36%	42%	33%	51%
Non-GAAP operating margin	-22%	-9%	-11%	4%	-5%	3%	-7%	14%	8%	14%	5%	23%
Non-GAAP net margin	-21%	-8%	-9%	6%	-2%	5%	-4%	16%	10%	15%	7%	23%

Source: the Company, Guotai Junan International.



**Table 9: Financial Statements of Youku**

Income Statement (Dec Year End mn RMB)	2012	2013	2014E	2015E	2016E
Net Revenues	1,796	3,028	4,000	5,641	8,066
Cost of Revenues	(1,500)	(2,487)	(3,037)	(3,756)	(4,598)
<b>Gross profit</b>	296	541	963	1,884	3,468
Sales and Marketing	(364)	(681)	(946)	(1,185)	(1,613)
General and Administrative	(238)	(262)	(270)	(338)	(468)
Product Development	(173)	(278)	(420)	(423)	(565)
<b>Operating Income</b>	(479)	(680)	(672)	(62)	823
net finance cost	41	29	61	141	155
Other Income (Loss), Net	10	71	4	0	0
<b>Earnings before Taxes</b>	(427)	(580)	(607)	79	978
Provision for Income Tax	3	(1)	(0)	0	(98)
<b>Net Income (Loss)</b>	(424)	(581)	(607)	79	880
Net loss per ADS, basic and diluted	(3.200)	(3.501)	(3.116)	0.393	4.256
Non-GAAP net loss (Profit) per ADS	(1.844)	(2.062)	(1.217)	2.104	6.483
ADS used in computation, basic and diluted mn shares	133	166	195	201	207
EBITDA	19	320	36	681	1,601
Non-GAAP net loss (Profit)	(245)	(342)	(255)	422	1,341

Balance Sheet (Dec Year End mn RMB)	2012	2013	2014E	2015E	2016E
<b>Current Assets</b>					
Cash and Cash Equivalents	1,656	1,764	6,902	7,175	8,355
Short-term Investments	2,110	1,409	1,409	1,409	1,409
Accounts Receivables	933	1,370	1,480	1,889	2,177
Amounts Due from Related Party	0	0	0	0	0
Deferred Tax Assets	10	8	7	6	6
Prepayments and Other Assets	65	82	92	154	197
Restricted Cash	9	3	3	3	3
Intangible Assets, Net	20	52	55	57	60
<b>Total Current Assets</b>	4,803	4,688	9,947	10,694	12,207
<b>Non Current Assets</b>					
Property and Equipment, net	201	222	232	242	253
Long-term Investment in Related Party	0	0	0	0	0
Amounts Due from Related Party	0	0	0	0	0
Goodwill	4,256	4,263	4,263	4,263	4,263
Intangible Assets, Net	1,305	1,198	1,312	1,378	1,447
Capitalized Content Production Costs	0	1	0	0	0
Prepayments and Other Assets	229	198	220	369	474
<b>Total Non- Current Assets</b>	5,990	5,882	6,027	6,252	6,436
<b>Total Assets</b>	10,793	10,570	15,974	16,946	18,643
<b>Current Liabilities</b>					
Accounts Payable	182	214	269	328	403
Accrued Expenses and Other Liabilities	981	1,124	1,205	1,573	1,828
Advances from Customers	7	0	0	0	0
Amounts Due to Related Party	22	25	37	50	74
others	0	0	0	0	0
<b>Total Current Liabilities</b>	1,192	1,363	1,511	1,952	2,305
<b>Non Current Liabilities</b>					
Long-term Debt	0	0	0	0	0
Deferred tax liability	224	220	215	211	207
Other Liabilities	20	4	4	4	4

total Non-current Liabilities	244	224	219	215	211
<b>Total Liabilities</b>	<b>1,436</b>	<b>1,587</b>	<b>1,731</b>	<b>2,167</b>	<b>2,516</b>
<b>Total Shareholders Equity</b>	<b>9,357</b>	<b>8,983</b>	<b>14,244</b>	<b>14,779</b>	<b>16,127</b>
<b>Total Liabilities &amp; Shareholders Equity</b>	<b>10,793</b>	<b>10,570</b>	<b>15,974</b>	<b>16,946</b>	<b>18,643</b>
BVP ADS	70.5	54.1	73.1	73.6	78.0

Cash Flow Statements (Dec Year End mn RMB)	2012	2013	2014E	2015E	2016E
<b>Operating Activities</b>					
Net Income	(424)	(581)	(607)	79	880
Depreciation	82	132	146	152	159
Amortization of Intangible Assets and Self Produced Content	416	868	562	590	620
Share Based Compensation	118	188	326	319	431
Bad Debt Expenses	10	63	68	86	99
other	(11)	(33)	0	0	0
<b>working capital change</b>					
Accounts Receivable	(224)	(500)	(110)	(410)	(288)
Accounts Payable	(39)	(14)	55	59	75
Restricted Cash	(9)	6	(0)	(0)	(0)
Accrued Expense and Other Liabilities	215	142	81	368	255
Advances from Customers	(7)	3	12	14	24
Amounts Due from Related Party	0	0	0	0	0
Prepayments and Other Assets	20	1	(32)	(211)	(148)
Capitalized Content Production Costs	(10)	(7)	(8)	(10)	(13)
<b>Cash Flow from Operating Activities</b>	<b>137</b>	<b>269</b>	<b>493</b>	<b>1,036</b>	<b>2,093</b>
<b>Investing Activities</b>					
Acquisition of Property and Equipment	(90)	(144)	(156)	(162)	(170)
Proceeds from Disposal of Property and Equipment	0	0	0	0	0
Cash Paid for Acquired Subsidiaries, Net of Cash Received	379	(7)	0	0	0
Acquisition of Intangible Assets	(362)	(741)	(625)	(656)	(689)
others	(711)	636	(321)	(116)	(285)
<b>Cash Flow from Investing Activities</b>	<b>(784)</b>	<b>(255)</b>	<b>(1,101)</b>	<b>(934)</b>	<b>(1,143)</b>
<b>Financing Activities</b>					
Principal Repayment on Long-term Debt	(11)	(8)	0	0	0
Drawdown of Long-term Debt	0	0	0	0	0
Principal Repayments on Short-term Loan	(32)	0	0	0	0
Proceeds from IPO and Secondary Offering, net of issuance costs	0	0	7,430	0	0
Exercise of Employee Stock Option	0	0	(1,860)	0	0
others	22	101	176	172	232
<b>Cash Flow from Financing Activities</b>	<b>38</b>	<b>(0)</b>	<b>0</b>	<b>0</b>	<b>0</b>
	18	94	5,746	172	232
<b>Other Adjustments</b>					
Foreign Exchange Rate Effect on Cash	(8)	0	0	0	0
<b>Cash Flow Net Changes in Cash</b>	<b>(637)</b>	<b>108</b>	<b>5,138</b>	<b>273</b>	<b>1,180</b>
BB	2,293	1,656	1,764	6,902	7,175
EB	1,656	1,764	6,902	7,175	8,355

key ratios (Dec Year End mn RMB, %)	2012	2013	2014E	2015E	2016E
<b>GAAP</b>					
Growth YoY					
Revenue	48%	83%	78%	96%	84%
Operating profit	161%	42%	-1%	-91%	-1431%
EBITDA	-33%	1554%	-89%	1804%	135%
Net profit	146%	37%	5%	-113%	1014%

Margins					
Gross margin	16%	18%	24%	33%	43%
Operating margin	-27%	-22%	-17%	-1%	10%
EBITDA margin	1%	11%	1%	12%	20%
Net margin	-24%	-19%	-15%	1%	11%
<b>Non-GAAP</b>					
Non-GAAP gross profit	335	601	1,027	1,946	3,547
Non-GAAP operating profit	(299)	(441)	(319)	275	1,277
Non-GAAP EBITDA (Loss) Profit	(424)	(581)	(607)	79	880
Non-GAAP net profit	(245)	(342)	(255)	422	1,341
Stock-Based compensation	118	188	326	319	431
<b>Growth YoY</b>					
Revenue	64%	79%	71%	89%	82%
Operating profit	120%	47%	-28%	-191%	364%
EBITDA	146%	37%	5%	-113%	1014%
Net profit	96%	40%	-26%	-278%	217%
<b>Margins</b>					
Gross margin	19%	20%	26%	34%	44%
Operating margin	-17%	-15%	-8%	5%	16%
EBITDA margin	11%	18%	10%	18%	25%
Net margin	-14%	-11%	-6%	7%	17%
<b>ROE</b>	-6%	-6%	-5%	1%	6%
Average net margin (operating leverage)	-24%	-19%	-15%	1%	11%
Asset turnover (operating leverage)	26%	33%	34%	39%	52%
Asset/equity (financial leverage)	114%	116%	51%	42%	41%
<b>ROA</b>	-5%	-5%	-10%	1%	14%
<b>IC</b>	9,364	8,983	14,244	14,779	16,127
<b>ROIC</b>	-6%	-6%	-5%	1%	6%
<b>FCF</b>	64	(622)	(271)	218	1,235
Net det	(1,648)	(1,764)	(6,902)	(7,175)	(8,355)
Net gearing ratio excl. minority	Net Cash	-Net Cash	Net Cash	Net Cash	Net Cash

Source: the Company, Guotai Junan International.

### Company Rating Definition

The Benchmark: NASDAQ Composite Index

Time Horizon: 6 to 18 months

Rating	Definition
Buy	Relative Performance >15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

### Sector Rating Definition

The Benchmark: NASDAQ Composite Index

Time Horizon: 6 to 18 months

Rating	Definition
Outperform	Relative Performance >5%; or the fundamental outlook of the sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	Relative Performance <-5%; or the fundamental outlook of the sector is unfavorable.

### DISCLOSURE OF INTERESTS

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