



Yandex

Yandex N.V.

NYSE: YNDX

Recommendation: **Sell / Trim**

Jeremy Hu and David McMurtrie



Investment Thesis

Recommendation:

Due to the geopolitical uncertainty, volatility of Russia's Rubble and oil prices, and potential success of Yandex.Taxi, we believe a **Sell / Trim** is the most fitting decision.

Rationale:

Yandex NV (NASDAQ: YNDX) is the primary search and portal platform across Europe and more specifically within Russia. Their forefront positioning coupled with Yandex's continued innovation and investments into its diverse products and services ensure its competitive advantage. However, the stock market slightly overvalues Yandex stock by ignoring the political climate and associated risks that need to be addressed.

- 1 Yandex.Taxi is officially breaking even and hinting towards success
- 2 The Russian State is heavily involved in Yandex's interests
- 3 The volatility of the macroeconomic and oil environment heavily influence Yandex's value

Price Target: \$31.84
downside to current price of \$35.98
Downside: **-11.51%**

Company Overview

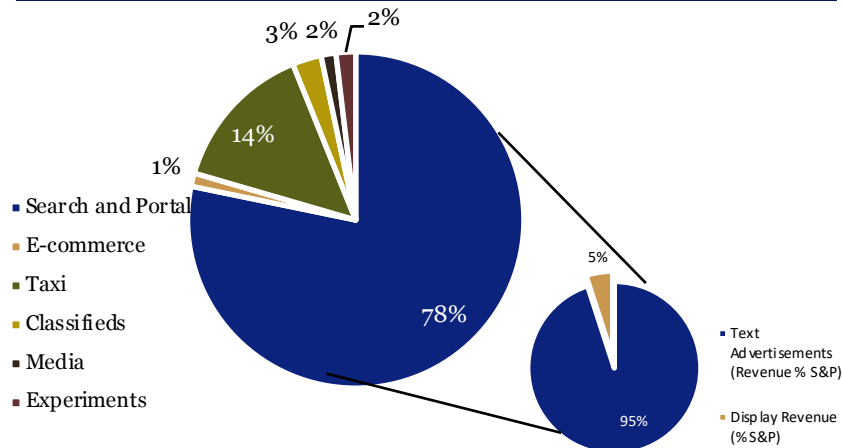
Yandex ("The Russian Google")

- One of the largest internet companies in Europe
 - Russia's most popular search engine and visited site
- Operating segments: Search & Portal, E-Commerce, Taxi, Media, Classifieds, Experimental Models
- Advertising is their strongest revenue base (95%)
- Sberbank is the biggest investor in the business
- High class talent, run similar to a "start up", creativity, collaboration, and constant innovation

Key Financial Data

Revenue \$1.83B	EBITDA \$475.2M	Market Cap \$11.5B	Total Debt 0	P/E 16.9
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Revenue Mix



Management Team



Arkady Volozh – CEO ('00-'20), Executive Director

- Founder of Yandex
- Successful serial IT entrepreneur, background in Computer Science
- On the "Kremlin List"
- Directly or indirectly controls 85% of Class B shares, holds 49% of voting power of outstanding shares



Herman Gref – Non-Executive Director ('14-'20)

- Minister for Economic Development of the Russian Federation (2000 – 2007)
- CEO and Chairman of Sberbank, largest savings bank in Russian Federation (2007 – present)
- On the "Kremlin List" as well

5-Year Performance





Operating Segments

Search and Portal

- Represent 57% of search traffic in Russia
- Increasing mobile search
 - Mobile search share surpassed Google, as a result of introduction of turbo pages (increase traffic and stay time, decrease bounce rate)
 - Increasing mobile search might negatively impact revenue and margin
- Increasing revenue from Yandex ad network (18%)
 - Might put downward pressure on operating margins as Yandex pays larger percentage of advertising fees
- Preparing to launch search and portal in Turkey

E - Commerce

- Formed Yandex.Market joint venture between Sberbank and Yandex in April 2018. (the two companies share equal stakes in the company)
- Yandex.Direct is an online auction-based advertisement placement platform

Media

- Most recent success from the Experiment pipeline; Revenue was RUB 679mm and grew 69% yoy
- EBITDA loss is expanding due to investment in content and product development; Will have a negative impact on overall cash flows
- In April 2018, Yandex was sued by state-owned company, Gazprom Media, for internet piracy, which led to threats of a ban on Yandex's video service

Taxi

Market Leader

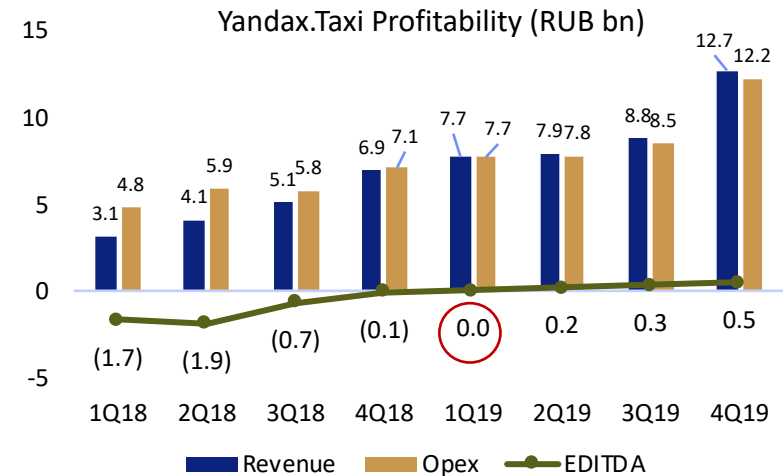
- Yandex.Taxi is the leader in the market with Revenue in 2018: RUB174bn
- Robust improvement with 112% yoy growth of taxi rides; and fast network expansion (167+ cities)

Joint Venture

- Formed the joint venture with Uber local service in Feb. 2018. 60% of taxi business is owned by Yandex
- The joint venture is actively developing food delivery service and autonomous car project

Breakeven

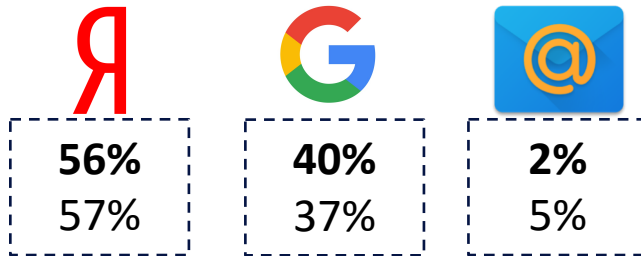
- Net loss is diminishing and profit will turn positive. The strong revenue-generating ability will overcome the heavy investment in the taxi, food delivery, and auto-driving service



Industries Update

Search Engine Market

Major Players



Current Activities

- Yandex is gaining market share in mobile search and maintaining its leadership position in overall search market
- Google is conducting extensive advertising campaigns in Russia, thus exerting pressure on Mobile search market
- Mail.ru continues to lose search engine market share

Industry Trends & Drivers

Increasing Internet Penetration

- Current penetration reached 63% (90.44 million people)
- Young generation is saturated; Older generation has growth potential

Increasing Online Advertising Expenditure

- Projected to grow at 11% in the next five years, which will increase revenue for search engines companies

Government Regulation Tightens

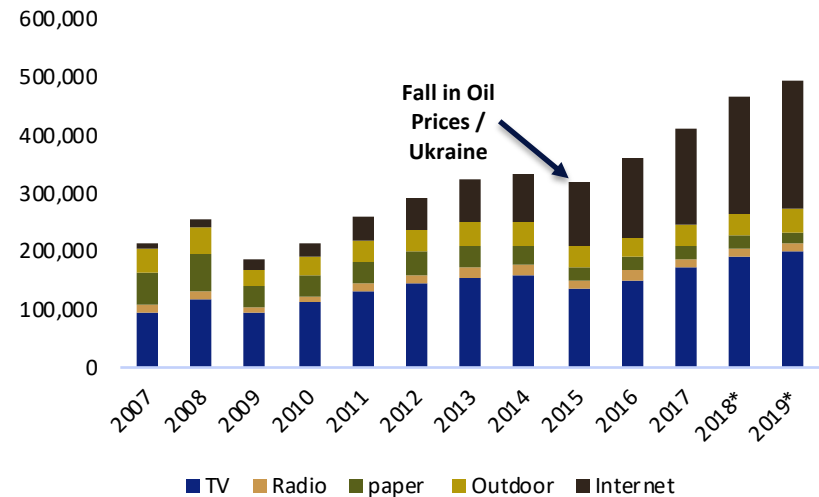
- Government censorship on internet industry could curb future investments and negatively impact business

Advertising Market

Current Situation

- Internet advertising expenditure is the largest advertising expenditure source, which shows that internet advertising is becoming the reliable, effective sources for advertising
- Increasing internet expenditure will provide internet companies with increased revenues
- Increasing internet market penetration will also allow for robust growth in the near future

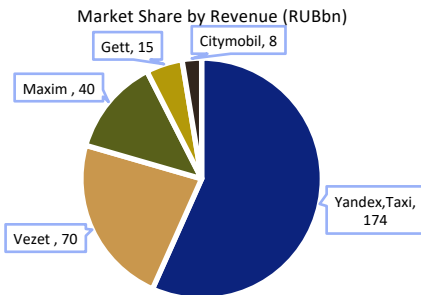
Ad Spending in Russia by medium(RUB mm)



1. Yandex Taxi

Russian Taxi Market

Major Players



Industry Trends & Risks

Taxi Market Has Robust Growth

- Market size grew three times '10 – '18 (RUB 238bn – 669bn)
- Moscow is leading the growth, driven by evolving customer habits from using personal vehicles to taxi services.

Favorable Regulation Environment

- Government is supportive of the online taxi providers

Decreasing Personal Vehicle Usage

- The paid parking charge and changing consumer habits
- The taxi market will thus further grow from the personal vehicle market

Pricing & Poor Customer Experience

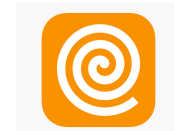
- Official taxi services are relatively expensive
- Customer demand better ride experience

Russian Food Delivery Market

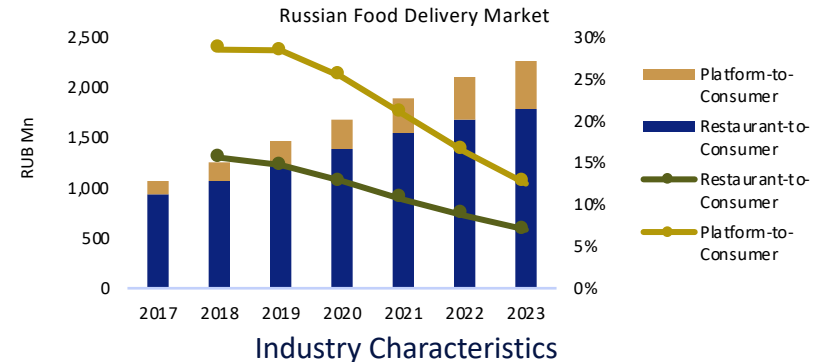
Major Players



Delivery Club 22%



Yandex Food 9%



Industry Characteristics

An Emerging Market

- The food delivery service is growing at 21% yoy; Yet the online deliveries only account for 1/3
- Russia food delivery market is only 4% the size of Chinese market. Thus it has huge growth potential

Growing Marketing Expenditure

- Increased promotion and marketing led to a spike in order growth (1.4mn to 2.4mn qtr orders), thus showing its success

New Competition

- Ozon decided to join online delivery market. The company has large user base and a strong network with local restaurants



2. Government's Involvement

Recent Government Activity

2017

- Government starts to restrict anonymity online
- Tightens control on media companies receiving foreign investments

2018

- Government strengthens internet censorship by blocking inappropriate content
- Government blocks Telegram for disobeying authority

Impact on Yandex

- Since Yandex is the biggest publicly owned internet company that operates in internet/information business sectors, the company has drawn more attention from the authoritarian-minded government
- The government will continue to increase censorship on the internet industry in the future. This might intimidate foreign investors and could also negatively affect Yandex's operating segments



3. Macroeconomics

Political Risks

Russia's conflict with Ukraine (2014)

Western countries have imposed economic sanctions on individuals and companies within Russia. It is uncertain when these sanctions will be lifted.

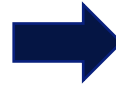


- Business in Ukraine was shut down
- Yandex.Money is under U.S. sanction
- The Founder and CFO are on "Kremlin List"
- Partnering with Sberbank could invoke further sanctions

Economic Risk

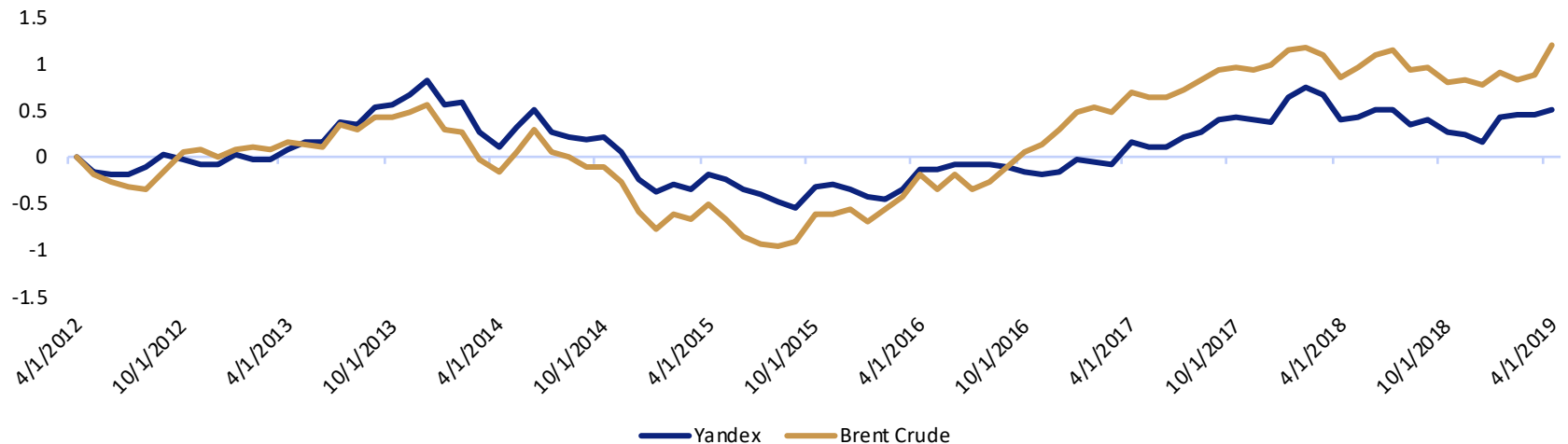
Economic Downturn

In 2014-15, Russia experienced economic downturn with depreciation of its currency and a fall in oil prices.



- The downturn caused a decline in disposable income, thus causing a steep decline in the values of stocks traded.
- Depreciation will increase personnel expenses, rent expenses, and capital expenditures.
- Will negatively affect international operations overseas.

Stacked Line Comparison between Yandex Stock Performance and Brent Crude Oil





Risk & Mitigation

Key Risks

- X Management team will be changed in 2020
- X CEO and CFO on the Kremlin List: possibility of US Sanctions
- X Tensions in Ukraine and volatility in oil prices continue to have macroeconomic effects including increased volatility in currency and a weaker business environment
- X Stream of revenue from advertisements is cyclical in nature and 80% is from online advertisements
- X Strong competition with Google
- X Yandex.Taxi might not generate significant profit in the future and could fail

Mitigants

- Capital restructure might happen in accordance with Russian Law
- No real intention of the US Government to impose any sanctions on Volozh or Gref
- Ruble strengthening (5%), oil prices increasing, inflation rates declining significantly and the rate of decline in GDP is moderating
- Online ad growth is at about 20%, no one advertiser makes up more than 1.2% of their revenue, Taxi revenues can alleviate advertisement down times
- Google is prohibited from arrangements prohibiting pre-installation of rival applications and is required to provide a choice to users in selecting their default search engine
- Strong partnership and heavy investment from Uber alleviates part of the risk



Then vs. Now

Why We Bought Yandex

- The stock was undervalued (\$19/share) due to Rubble depreciation and economic downturn as oil prices fell
- Yandex's potential business growth coupled with undervalued stock price
- Partnership with Android-based phone producers
- Growth in smartphone and tablet usage in Russia

What has Changed

- Russia economy is strengthening
- Stock price is slightly overvalued as it ignores macroeconomic factors
- Future geopolitical situation with Ukraine and U.S. remains unclear
- Oil prices have rebounded since 2015 but its future price still remains uncertain
- Russian State has limited Google's abilities to interfere with Yandex's reach
- Continued improvements with AI and Alice ("Siri")



Yandex

Base Case

Current Price: \$35.98

Price Target: \$31.84

Downside: -11.51%

Recommendation:

Due to the geopolitical uncertainty, volatility of Russia's Rubble and oil prices, and potential success of Yandex.Taxi, we believe a **Sell / Trim** is the most fitting decision.

Valuation



Valuation Statistics

Company	Ticker	Market Capitalization	Enterprise Value	EV / Revenue		EV / EBITDA		Price / Earnings	
				2018A	LTM	2018A	NTM	2018A	NTM
Alphabet Inc.	GOOG	\$838,429	\$733,301	4.8x	5.4x	15.8x	12.4x	39.2x	25.9x
Baidu, Inc.	BIDU	64,552	53,603	3.3x	3.5x	9.3x	16.0x	12.9x	20.3x
Twitter, Inc.	TWTR	26,691	23,203	6.5x	7.5x	27.5x	18.2x	21.2x	40.7x
Facebook, Inc.	FB	499,248	458,634	6.5x	8.3x	11.8x	12.5x	19.8x	23.0x
Mail.ru Group Limited	MAIL	5,226	5,234	5.1x	5.5x	65.2x	11.2x	12.6x	18.9x
Weibo Corporation	WB	16,015	15,073	7.6x	8.4x	20.5x	20.0x	24.7x	23.8x
Yandex N.V.	YNDX	\$11,614	\$10,743	4.6x	5.8x	18.6x	13.4x	13.3x	16.9x

Low	\$5,226	\$5,234	3.3x	3.5x	9.3x	11.2x	12.6x	18.9x
Mean	241,694	214,841	5.6x	6.4x	25.0x	15.1x	21.7x	25.4x
Median	45,622	38,403	5.8x	6.5x	18.2x	14.3x	20.5x	23.4x
High	838,429	733,301	7.6x	8.4x	65.2x	20.0x	39.2x	40.7x

Operating Statistics

Company	Ticker	Revenue		Revenue Growth		EBITDA		EBITDA Margin	
		2018A	LTM	'17-'18A	LTM	2018A	LTM	2018A	LTM
Alphabet Inc.	GOOG	\$129,866	\$136,819	24.2%	23.4%	\$39,334	\$40,421	30.3%	29.5%
Baidu, Inc.	BIDU	15,028	15,465	25.1%	26.5%	5,344	4,960	35.6%	32.1%
Twitter, Inc.	TWTR	2,865	3,042	18.0%	39.6%	674	771	23.5%	25.4%
Facebook, Inc.	FB	51,896	55,838	42.2%	39.6%	28,388	29,228	54.7%	52.3%
Mail.ru Group Limited	MAIL	960	1,010	30.8%	32.0%	80	16	8.4%	1.6%
Weibo Corporation	WB	1,614	1,719	63.8%	49.4%	598	635	37.1%	37.0%
Yandex N.V.	YNDX	\$1,783	\$1,951	32.1%	35.7%	\$435	\$506	24.4%	25.9%

Low	\$960	\$1,010	18.0%	23.4%	\$80	\$16	8.4%	1.6%
Mean	33,705	35,649	34.0%	35.1%	12,403	12,672	31.6%	29.7%
Median	8,946	9,254	28.0%	35.8%	3,009	2,866	33.0%	30.8%
High	129,866	136,819	63.8%	49.4%	\$39,334	\$40,421	54.7%	52.3%

Valuation - WACC



Capital Structure	
Debt-to-Total Capitalization	- %
Equity-to-Total Capitalization	100.00%
<u>Cost of Debt</u>	
Cost of Debt	- %
Tax Rate	20.60%
After-tax Cost of Debt	0.00%
<u>Cost of Equity</u>	
Risk-free Rate ⁽¹⁾	4.00%
Market Risk Premium ⁽²⁾	6.00%
Levered Beta	1.00
Cost of Equity	10.00%
WACC	10.00%



Valuation – DCF (Base)

(Rubles in millions)	FYE December 31,				FYE December 31,						
	2015A	2016A	2017A	2018A	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Total Revenue	\$59,792.0	\$75,925.0	\$94,054.0	\$127,657.0	\$166,322.6	\$202,721.4	\$236,163.0	\$264,096.4	\$285,886.0	\$299,835.0	\$314,474.1
Revenue Growth	--	27.0%	23.9%	35.7%	30.3%	21.9%	16.5%	11.8%	8.3%	4.9%	4.9%
Expenses											
COGS	16,810.0	19,754.0	23,937.0	35,890.0	47,900.5	58,788.5	67,081.3	72,086.0	74,449.6	73,829.7	72,962.2
Gross Profit	\$42,982.0	\$56,171.0	\$70,117.0	\$91,767.0	\$118,422.1	\$143,932.9	\$169,081.7	\$192,010.4	\$211,436.4	\$226,005.3	\$241,512.0
Gross Margin	71.9%	74.0%	74.5%	71.9%	71.2%	71.0%	71.6%	72.7%	74.0%	75.4%	76.8%
Operating Expenses	32,813.0	43,324.0	57,081.0	70,906.0	89,126.7	105,692.2	119,703.1	130,032.2	136,615.3	138,933.5	141,156.9
Operating Income (EBIT)	\$10,169.0	\$12,847.0	\$13,036.0	\$20,861.0	\$29,295.4	\$38,240.7	\$49,378.6	\$61,978.2	\$74,821.1	\$87,071.8	\$100,355.1
EBIT Margin	17.0%	16.9%	13.9%	16.3%	17.6%	18.9%	20.9%	23.5%	26.2%	29.0%	31.9%
Income Tax Expense (24%)	3,917.0	4,324.0	4,926.0	8,603.0	7,909.7	10,325.0	13,332.2	16,734.1	20,201.7	23,509.4	27,095.9
EBIAT	\$6,252.0	\$8,523.0	\$8,110.0	\$12,258.0	\$21,385.6	\$27,915.7	\$36,046.4	\$45,244.1	\$54,619.4	\$63,562.4	\$73,259.2
Cash Flow											
Plus: SBC	2,718.0	3,422.0	4,193.0	6,552.0	8,536.5	10,404.7	12,121.1	13,554.8	14,673.1	15,389.0	16,140.4
Plus: D&A	7,791.0	9,607.0	11,239.0	12,137.0	14,969.0	18,244.9	21,254.7	23,768.7	25,729.7	26,985.2	28,302.7
Discretionary Cash Flow	\$16,761.0	\$21,552.0	\$23,542.0	\$30,947.0	\$44,891.2	\$56,565.4	\$69,422.1	\$82,567.5	\$95,022.2	\$105,936.6	\$117,702.3
Less: Increase in NWC		(2,068.0)	274.0	1,319.0	(1,361.1)	(1,084.4)	(191.5)	744.4	1,305.4	1,839.2	2,032.3
Less: CapEx	13,045.0	9,625.0	12,389.0	28,323.0	24,948.4	30,408.2	35,424.5	39,614.5	42,882.9	44,975.3	47,171.1
Free Cash Flow	\$29,806.0	\$33,245.0	\$35,657.0	\$1,305.0	\$21,303.9	\$27,241.6	\$34,189.2	\$42,208.6	\$50,833.9	\$59,122.1	\$68,498.8
Free Cash Flow Growth			7.3%	(96.3%)	1532.5%	27.9%	25.5%	23.5%	20.4%	16.3%	15.9%
Unlevered Free Cash Flow											
WACC	10.00%										
Discount Period					0.5	1.5	2.5	3.5	4.5	5.5	6.5
Discount Factor					0.95	0.87	0.79	0.72	0.65	0.59	0.54
Present Value of Free Cash Flow					\$20,312.4	\$23,612.6	\$26,940.6	\$30,236.2	\$33,104.5	\$35,001.8	\$36,866.4



Valuation – DCF (Base)

DCF Implied Equity Value and Share Price

Enterprise Value	\$11,386.1
<i>Less: Total Debt</i>	--
<i>Plus: Cash & Cash Equivalents</i>	\$1,032.0

Implied Equity Value \$12,418.0

Implied Share Price \$38.24

Shares Outstanding 325

Comps Implied Equity Value and Share Price

Enterprise Value	\$7,224.6
<i>Less: Total Debt</i>	--
<i>Plus: Cash & Cash Equivalents</i>	\$1,032.0

Implied Equity Value \$8,256.6

Implied Share Price \$25.43

Shares Outstanding 325

Method	Weight	Price
Comparable Companies	50%	\$25.43
DCF	50%	\$38.24
Fair Value Estimate		\$31.84

Enterprise Value

Cumulative Present Value of FCF \$3,091.1

Terminal Value

Terminal Year Cash Flow \$1,027.5

Exit Multiple 15.0x

Terminal Value \$15,412.2

Discount Factor 53.82%

Present Value of Terminal Value \$8,294.9

% of Enterprise Value 72.9%

Enterprise Value \$11,386.1

DCF Sensitivity Analysis

	WACC				
	8.0%	9.0%	10.0%	11.0%	12.0%
11.0x	\$34.51	\$32.92	\$31.43	\$30.03	\$28.72
13.0x	\$38.35	\$36.54	\$34.84	\$33.25	\$31.75
15.0x	\$42.19	\$40.15	\$38.24	\$36.46	\$34.78
17.0x	\$46.03	\$43.77	\$41.65	\$39.67	\$37.81
19.0x	\$49.87	\$47.38	\$45.06	\$42.88	\$40.84

EV/EBITDA