

**Company updates**

# Alibaba Group

**China | Consumer Discretionary**
**Research Team**

Rating BUY (as at 31 December 2020)  
 Last Close HKD 228.20  
 Fair Value HKD 331.00

## Regulatory clouds build

- **Recent developments point to tougher regulatory backdrop...**
- **...but authorities should conceivably strike a balance between innovation and regulation**
- **Share repurchased programme upsized; remain constructive on longer-term prospects despite near-term headwinds**

## Investment thesis

While the past two decades have been characterized by the rapid development of e-commerce, Alibaba's earnings growth in the next decade will be driven by monetising user engagement across its ecosystem, which covers almost the entire consumption journey – from the online marketplace to logistics, payments and cloud services. With its leadership in e-commerce and cloud services, Alibaba is well positioned to benefit from the trend of accelerated digitalisation post COVID-19.

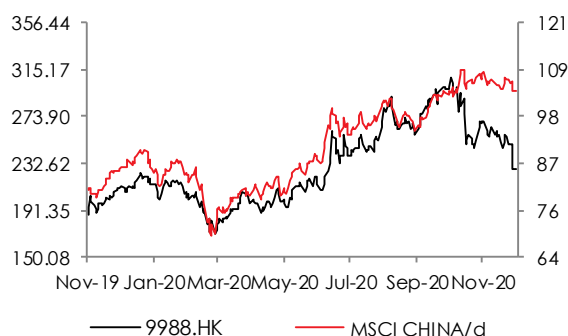
## Investment summary

- **Investigation underway** – The State Administration of Market Supervision (SAMR) announced on 24 Dec that it has initiated an investigation into Alibaba Group for suspected monopolistic behaviour such as the alleged "Two-Choose-One" practice. Alibaba has confirmed in a Weibo post that it will be co-operating with the investigation in relation to the Anti-Monopoly Law. In our view, of the different internet sub-sectors, anti-trust regulations probably has the greatest impact on the e-commerce vertical. The use of subsidies/discounts may constitute unfair competition, while strict enforcement against "Two-Choose-One" (i.e. forced exclusivity, as per the above allegations) practices, and potential impact on recommendation feeds could pose a potential headwind to e-commerce leaders. This comes on the heels of related developments in recent days, including (a) China's Politburo signalling a strengthening of anti-monopoly reviews in 2021 in its annual Economic Work Conference, and (b) SAMR fining Alibaba, China Literature and Fengchao Network RMB 500k each for

## Security information

Ticker	9988.HK
Market Cap (USD b)	600.7
Daily turnover (HKD m)	27.2
Free Float	69%
Shares Outstanding (m)	21,492
Top Shareholder	SoftBank Group Corp 24.9%

## Price performance chart



## Financial summary

RMB m	FY20	FY21F	FY22F
Revenue	509,711	671,490	841,625
Gross Profit (adj)	234,666	307,790	391,356
Operating Profit (adj)	123,748	171,783	224,740
PATMI (adj)	132,479	178,348	234,012
EPS (RMB adj)	6.6	8.4	10.9

## Key ratios

	FY20	FY21F	FY22F
Revenue growth	35.3%	31.7%	25.3%
Gross margin (adj)	46.0%	45.8%	46.5%
Operating margin (adj)	24.3%	25.6%	26.7%
Net margin (adj)	26.0%	26.6%	27.8%
EPS growth (adj)	38.0%	27.5%	29.4%

Source: Refinitiv, Company, Internal estimates

failing to seek regulatory approval before making acquisitions of/investments in certain companies.

- **Lack of clarity still; all about the eventual degree of enforcement** – In our view, despite the newsflow, the key unknown still remains unaddressed, and that is of the degree of regulatory enforcement. A strict implementation of the rules would naturally limit market leaders' operational flexibility. However, if history is a guide, the enforcement of similar regulations in the China internet space (especially for e-commerce) has proven to be challenging – the E-commerce Law in Jan 2019 appears to have limited impact on the market leaders thus far. "Two-Choose-One" practices have been discussed back then, and still remain part of the discussions today. Still, even if one were to adopt a more hawkish view, we believe that the authorities would also have to balance between innovation and regulation as it deals with Alibaba given the industry-wide ramifications, which is in-line with our base-case that a break-up or existential threat to the group is not imminent.
- **Long term play; patience needed** – As a recap, on a fundamental level, 2QFY21 saw marketplace-based core commerce adjusted EBITDA grow at a more modest pace due to investments in the core-commerce segment, but yet encouragingly core commerce new initiatives saw losses narrow YoY. We tend to agree with management that a more holistic view of the business is required, and opine that investors should consider both the ongoing investment and harvesting cycles within the group. Despite the near-term headwinds that will likely weigh on multiples, **we continue to advocate patience and remain constructive on Alibaba (BABA US / 9988 HK) over the longer-term.** Valuations are inexpensive in our view, with BABA US trading at 18.4x blended forward consensus P/E, which is even below the recent low in mid-2019. Separately, Alibaba has also announced that the group has been authorised to upsize its share repurchase programme from USD6b to USD10b. The share repurchase programme will be effective for a 2-year period through the end of 2022, and the programme has commenced this quarter. We see this as a sign of confidence by the company on its share price coupled with the announcement last week that company will actively cooperate with regulators. However, we acknowledge that continued antitrust newflow would likely present relatively stiffer near-term headwinds to the company, in comparison to JD.com (JD US / 9618 HK) or Tencent (700 HK).

## Potential catalysts

- Faster-than-anticipated turnaround of its cloud and/or digital entertainment segments
- Inclusion in Stock Connect to attract more funds inflows

## Investment risks

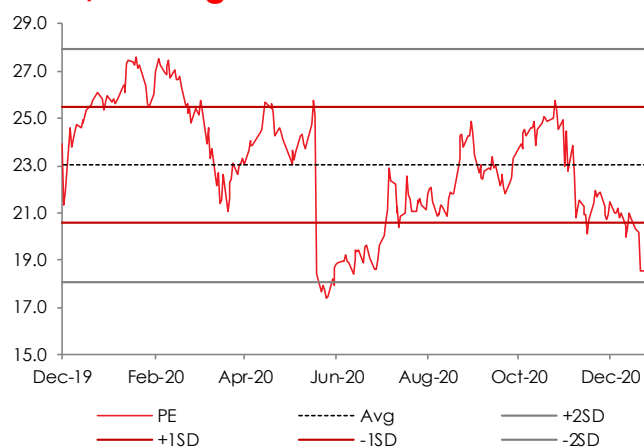
- Significant slowdown in its core-commerce business
- Reported GMV numbers may be inflated due to counterfeit goods and practices like "brushing"
- Regulatory risks related to its operations in China and listing in the US

## Valuation analysis

	Price/Earnings		Price/Book		EV/EBITDA		Dividend Yield (%)		ROE (%)	
	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F
<b>ALIBABA GROUP HOLDING LTD (BABA.N)</b>	21.4	17.7	4.4	3.6	17.9	14.1	0.0	0.0	18.3	18.2
<b>AMAZON.COM INC (AMZN.OQ)</b>	90.9	69.9	16.7	12.5	28.8	22.6	0.0	0.0	26.3	27.5
<b>JD.COM INC (JD.OQ)</b>	51.4	36.3	7.0	6.0	36.6	25.4	0.0	0.0	18.5	15.2
<b>PINDUODUO INC (PDD.O)</b>	N.A	276.9	52.9	47.7	N.A	1,118.3	0.0	0.0	(21.9)	5.7
<b>TENCENT HOLDINGS LTD (0700.HK)</b>	36.6	29.1	8.0	6.4	25.7	21.2	0.3	0.3	23.9	22.9

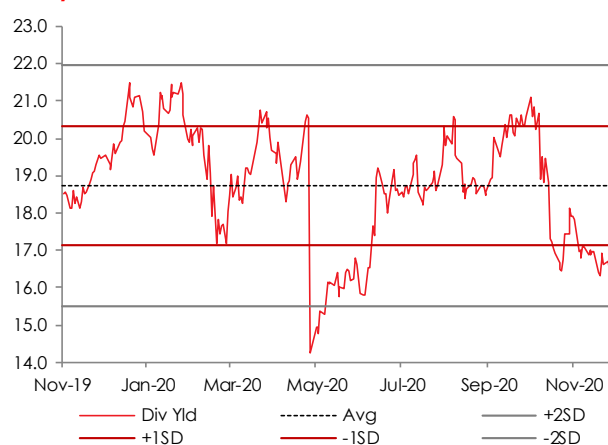
Source: Refinitiv

## Price/Earnings chart



Source: Refinitiv

## EV/EBITDA



Source: Refinitiv

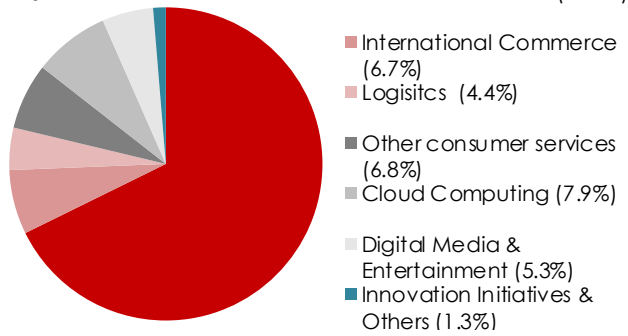
## Company overview (as of 31 March 2020)

### Company description

Alibaba is the largest online and mobile commerce company in the world in terms of gross merchandise volume. It operates China's largest online shopping destination, Taobao Marketplace and China's largest third-party platform for brands and retailers, Tmall. The company does not engage in direct sales nor does it compete with its merchants or hold inventory; instead it monetises its online market services by collecting commissions, membership fees and storefront fees.

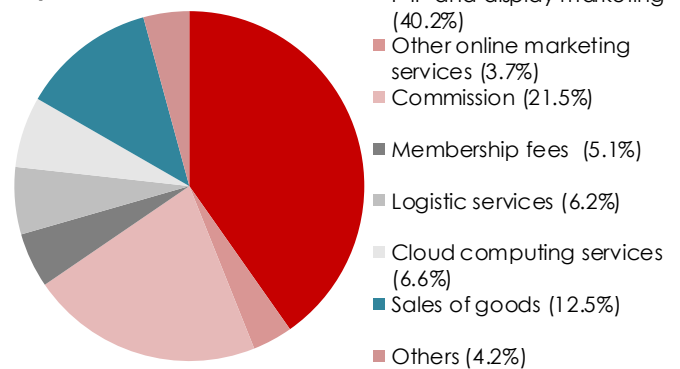
**FY3/20 revenue breakdown**

**By business**



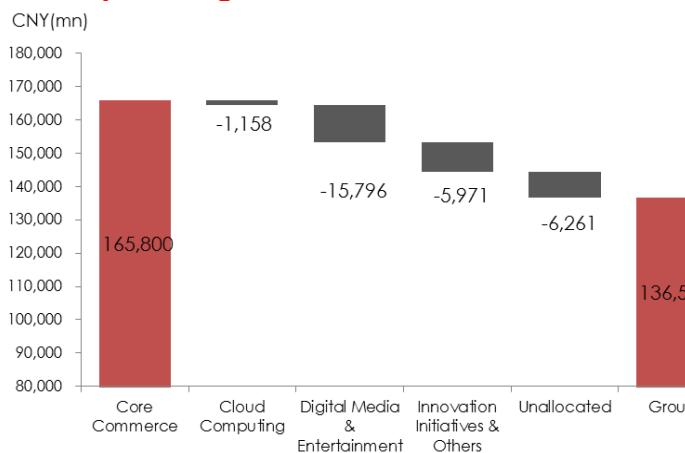
Source: Company

**By nature**



Source: Company

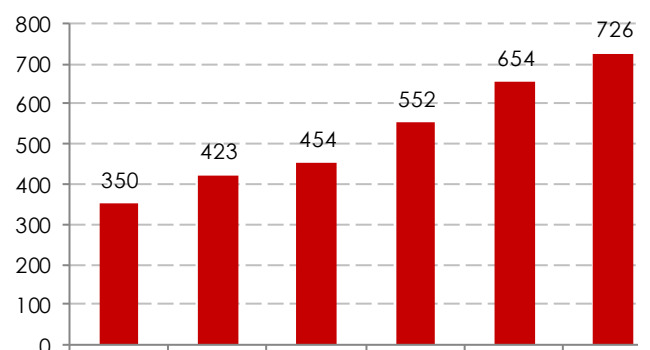
**FY20 operating income breakdown**



Source: Company

**Annual active users growth**

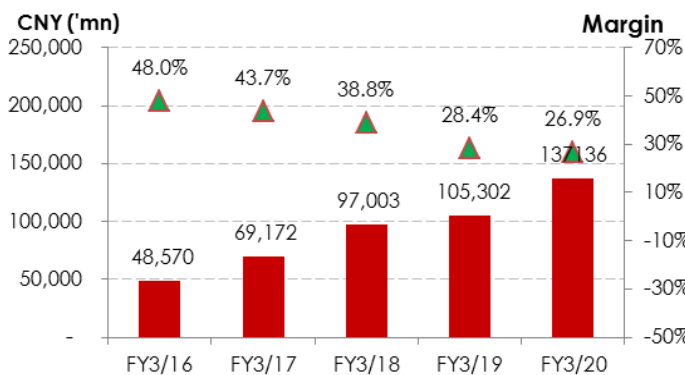
**Annual active buyers (m)**



For 12M ended 31 Mar

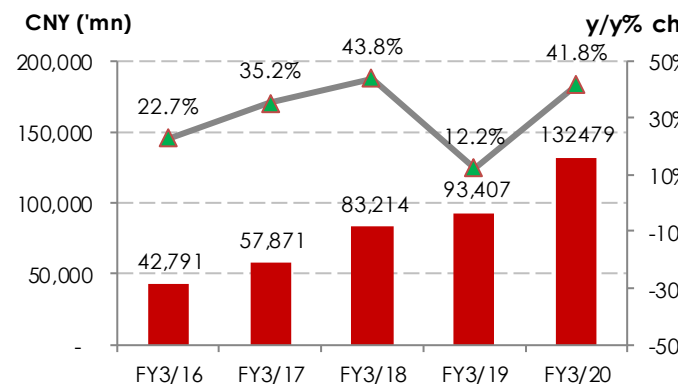
Source: Company

**Operating income and margin**



Source: Company

**Non-GAAP net profit**



Source: Company

## Company financials

In Millions of CNY except Per Share	FY2016	FY2017	FY2018	FY2019	FY2020
12 Months Ending	31/03/2016	31/03/2017	31/03/2018	31/03/2019	31/03/2020
<b>Revenue</b>	<b>101,143</b>	<b>158,273</b>	<b>250,266</b>	<b>376,844</b>	<b>509,711</b>
- Cost of Revenue	34,355	58,626	106,243	204,086	279,713
<b>Gross Profit</b>	<b>66,788</b>	<b>99,647</b>	<b>144,023</b>	<b>172,758</b>	<b>229,998</b>
+ Other Operating Income	--	--	--	--	--
- Operating Expenses	38,852	53,981	76,726	126,888	150,586
<b>Operating Income or Losses</b>	<b>27,936</b>	<b>45,666</b>	<b>67,297</b>	<b>45,870</b>	<b>79,412</b>
- Interest Expense	1,946	2,671	3,566	5,190	5,180
- Foreign Exchange Losses (Gains)	--	--	--	--	--
- Net Non-Operating Losses (Gains)	-2,322	-6,350	-4,424	1,281	-7,536
<b>Pretax Income</b>	<b>81,468</b>	<b>60,029</b>	<b>100,403</b>	<b>96,221</b>	<b>166,645</b>
- Income Tax Expense (Benefit)	8,449	13,776	18,199	16,553	20,562
<b>Income Before XO Items</b>	<b>73,019</b>	<b>46,253</b>	<b>82,204</b>	<b>79,668</b>	<b>146,083</b>
- Extraordinary Loss Net of Tax	--	--	--	--	--
- Minority/Non Controlling Interests (Credits)	-1,901	-7,476	-23,365	-6,800	-14,646
<b>Net Income/Net Profit (Losses)</b>	<b>71,460</b>	<b>43,675</b>	<b>63,985</b>	<b>87,600</b>	<b>149,263</b>
<b>Net Inc Avail to Common Shareholders</b>	<b>71,460</b>	<b>43,675</b>	<b>63,985</b>	<b>87,600</b>	<b>149,263</b>
Abnormal Losses (Gains)	--	--	--	--	--
Tax Effect on Abnormal Items	--	--	--	--	--
<b>Normalized Income</b>	<b>75,334</b>	<b>49,848</b>	<b>103,999</b>	<b>94,958</b>	<b>177,793</b>
<b>Basic Earnings per Share</b>	<b>3.6</b>	<b>2.2</b>	<b>3.1</b>	<b>4.2</b>	<b>7.1</b>
Basic Weighted Av g Shares	19,664	19,944	20,424	20,640	21,017
<b>Diluted EPS Before Abnormal Items</b>	<b>3.5</b>	<b>2.1</b>	<b>3.1</b>	<b>4.2</b>	<b>7.0</b>
<b>Diluted EPS Before XO Items</b>	<b>3.5</b>	<b>2.1</b>	<b>3.1</b>	<b>4.2</b>	<b>7.0</b>
<b>Diluted EPS</b>	<b>3.5</b>	<b>2.1</b>	<b>3.1</b>	<b>4.2</b>	<b>7.0</b>
Diluted Weighted Av g Shares	20,496.0	20,584.0	20,880.0	20,984.0	21,346.0

### Profitability Ratios

	FY2016	FY2017	FY2018	FY2019	FY2020
12 Months Ending	31/03/2016	31/03/2017	31/03/2018	31/03/2019	31/03/2020
<b>Returns</b>					
Return on Common Equity	39.43	17.62	19.85	20.42	23.93
Return on Assets	23.57	10.62	13.43	9.47	12.83
Return on Capital	56.39	40.39	29.79	22.22	16.65
Return on Invested Capital	68.06	36.50	28.09	19.45	15.10
<b>Margins</b>					
Operating Margin	27.62	28.85	26.89	12.17	15.58
Incremental Operating Margin	0.91	1.04	0.93	0.45	1.28
Pretax Margin	80.55	37.93	40.12	25.53	32.69
Income before XO Margin	70.65	27.59	25.57	23.25	29.28
Net Income Margin	70.65	27.59	25.57	23.25	29.28
Net Income to Common Margin	70.65	27.59	25.57	23.25	29.28
<b>Additional</b>					
Effective Tax Rate	10.37	22.95	18.13	17.20	12.34
Dividend Payout Ratio	-	-	-	-	-
Sustainable Growth Rate	-	-	-	-	-

### Credit Ratios

	FY2016	FY2017	FY2018	FY2019	FY2020
12 Months Ending	31/03/2016	31/03/2017	31/03/2018	31/03/2019	31/03/2020
Total Debt/EBIT	1.89	1.86	1.41	2.23	1.15
Net Debt/EBIT	-1.90	-1.20	-0.95	-1.14	-2.19
EBIT to Interest Expense	15.68	18.47	24.91	11.63	20.98
Long-Term Debt/Total Assets	14.62	15.16	16.67	11.59	9.16
Net Debt/Equity	-0.12	-0.05	-0.03	0.11	-0.15

Source: Refinitiv

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