

21 Sep 2018

# Securities Analysis



## Alibaba (BABA US)

### Key takeaways from 2018 Investor Day

- ❖ **FY19E topline guidance unchanged.** We attended Alibaba 2018 Investor Day, where mgmt. reiterated "to make it easy to do business anywhere in the digital era" as mission. Mgmt maintained its FY19E revenue guidance (+60% YoY), with organic growth +50% YoY. Despite little financial surprise and macro headwinds, we still keep confident on Alibaba's long-term growth driven by robust core commerce, new retail and ecosystem synergies from continuous investments. Maintain BUY with TP and earnings unchanged.
- ❖ **All eyes on Chairman's retirement.** Jack MA shared his views on retirement, Alibaba's outlook, trade war and China's economy. He regarded the succession plan as a throughout decision prepared for 10 years, to train young leaders to fight for Alibaba's sustainable growth. We believe Mr. Ma's upcoming retirement has limited impact on Alibaba's business operations, as 1) Daniel Zhang (current CEO) was highly-competent with working in Alibaba for 11 years; 2) clear and well-prepared one-year transition period; and 3) Alibaba Partnership to ensure healthy corporate government. For the trade war and China's economy, Mr. Ma expected short-term negative impact on both China and USA from trade war, but in the long run, trade war will promote China's economy upgrade from exporting to importing, thus benefiting Alibaba in the upcoming "upper-grade economy".
- ❖ **Investing for future growth, awaiting more ecosystem synergies.** Daniel reiterated Alibaba's mission, and viewed Alibaba digital economy as a multi-business combination, with engines from robust consumer growth and consumption category expansion. Despite no FY19E guidance update, Maggie Wu emphasized strong Core momentum from recommendation improvement with new Taobao interface. We expect traffic mix shift to bring monetization upside for recommendation in the long run. Alibaba will step up investment on local services, New Retail, globalization, and techs, as Joe Tsai stated, which will still weigh on near-term margins. However, Alibaba has born initial fruits from synergies of investees (e.g. Youku). We expect more ecosystem synergies to be unlocked, further optimizing efficiency and stimulating growth.
- ❖ **Highlights from Day 3 Q&A Session.** In the 30-min internal Q&A session, key concerns focused on topline guidance, Ele.me impact and new ecommerce law. Mgmt expected better 2HFY19E growth thanks to easy comps, while full-quarter consolidation of Ele.me will drag 2QFY19E margin. However, mgmt. reiterated synergies of Ele.me from two aspects: 1) data & traffic sharing with *Koubei* and *Alipay*, to enhance accurate recommendation; and 2) higher tail-end logistics efficiency by applying drivers into more scenarios (e.g. *Hema Fresh*). Regarding ecommerce law, Mgmt mentioned limited impact from tax on Taobao merchants while more clear effect to be evaluated once the law come effect in Jan 2019.

#### Earnings summary

(YE Mar 31)	FY17A	FY18A	FY19E	FY20E	FY21E
Turnover (Rmb mn)	158,273	250,266	400,420	552,878	718,164
Adjusted net profit (Rmb mn)	60,252	85,766	101,919	139,296	181,634
Adjusted EPADS (Rmb)	23.4	32.9	38.9	52.8	68.2
EPADS CHG (%)	40.8%	40.3%	18.2%	36.0%	29.1%
PE (x)	48.0	34.2	28.9	21.3	16.5
PB (x)	8.9	6.7	5.7	4.7	3.8
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	18.6	19.5	19.7	22.1	23.1
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company, CMBIS estimates

### BUY (Maintain)

Target Price	US\$226.5
(Previous TP)	US\$226.5)
Up/downside	+37.1%
Current Price	US\$165.2

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#### Internet Sector

Mkt. Cap. (US\$m)	428,903
Avg. 3mths t/o (US\$m)	3,958.6
52W High/Low (US\$)	212/153
Total Issued Shares (mn)	2,571.9

Source: Bloomberg

#### Shareholding Structure

SoftBank	28.8%
Altaba Inc	14.8%
Jack Ma	5.3%

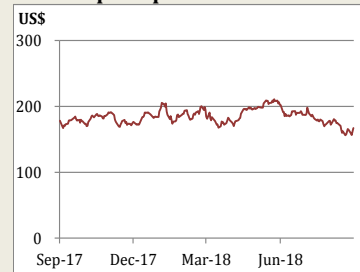
Source: Bloomberg

#### Share performance

	Absolute	Relative
1-mth	-7.7%	-7.1%
3-mth	-19.6%	-14.0%
6-mth	-16.7%	-4.6%

Source: Bloomberg

#### 12-mth price performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers

Web-site: www.alibabagroup.com

## FY19E topline guidance unchanged

**FY19E topline guidance unchanged.** We attended Alibaba 2018 Investor Day, where mgmt reiterated “to make it easy to do business anywhere in the digital era” as mission. Mgmt maintained its FY19E revenue guidance (+60% YoY), with organic growth +50% YoY. Despite little financial surprise and macro headwinds, we still keep confident on Alibaba’s long-term growth driven by robust core commerce, new retail and ecosystem synergies from continuous investments. Maintain BUY with TP and earnings unchanged.

Figure 1: SOTP valuation

US\$bn	Valuation		Methodology	Multiple Applied	Metrics
	US\$bn	Per share(US\$)		FY19E	FY19E
Core Commerce	497.5	189.7	EV/EBITA	20.0	24.9
Cloud	29.4	11.2	P/S	8.0	3.7
Others	67.1	25.6			
Digital Entertainment	12.9	4.9	P/S	3.5	3.7
Innovations	2.0	0.8	P/S	3.0	0.7
Strategic Investments	36.9	14.1	SoTP for all investments		
Net (Debt)/Cash	15.2	5.8	Cash forecasted on Balance sheet		
<b>Equity Value</b>	<b>594</b>	<b>226.5</b>			

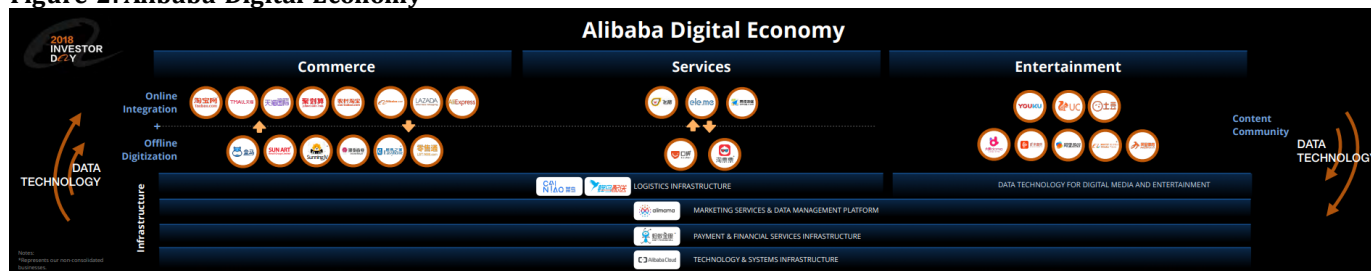
Source: CMBIS estimates

## Investing for future growth, awaiting more ecosystem synergies

### Daniel Zhang (CEO): Alibaba digital economy with multi-engines

Daniel reiterated Alibaba’s mission and strategy, and viewed Alibaba digital economy as a multi-business combination, with engines from robust consumer growth and consumption category expansion. For New Retail strategy, the ideal mechanism should be shifted from B2C to C2B model, based on demand-driven supply chain and data-powered product innovations. Moreover, Daniel shared his vision on IoT, globalization and near-term & long-term goals.

Figure 2: Alibaba Digital Economy



Source: Alibaba Investor Day 2018

Figure 3: Alibaba long-term vision

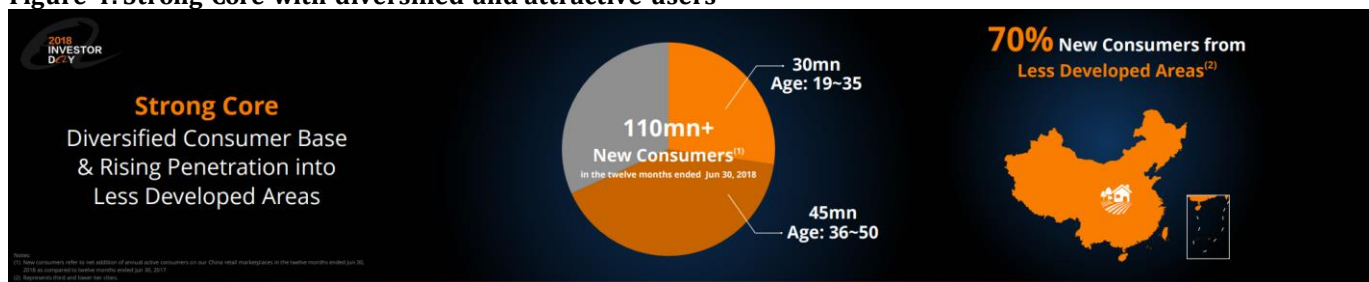


Source: Alibaba Investor Day 2018

## Maggie Wu (CFO): Strong Core driven by both user growth and recommendation monetization potentials

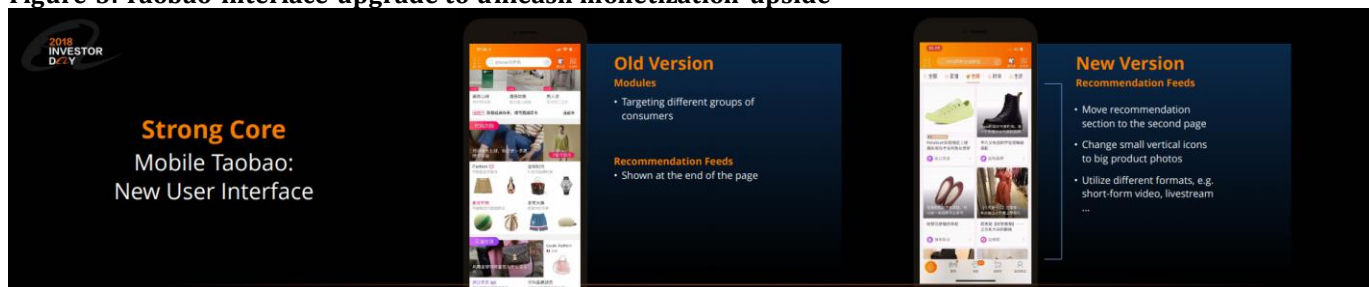
Despite no FY19E guidance update, Maggie Wu emphasized strong Core momentum from lower-tier use acquisition and recommendation improvement with new Taobao interface. We believe Alibaba will benefit from its diversified consumer base, as 70% new consumers came from less developed areas and ~27%/41% of new consumers at the age of 19~35/ 36~50. On top of that, 88VIP membership could strengthen user stickiness and achieve cross selling. Regarding data technology, Maggie mentioned the Taobao interface upgrade and recommendation traffic as complementary to search. We expect traffic mix shift to bring monetization upside for recommendation in the long run.

Figure 4: Strong Core with diversified and attractive users



Source: Alibaba Investor Day 2018

Figure 5: Taobao interface upgrade to unleash monetization upside

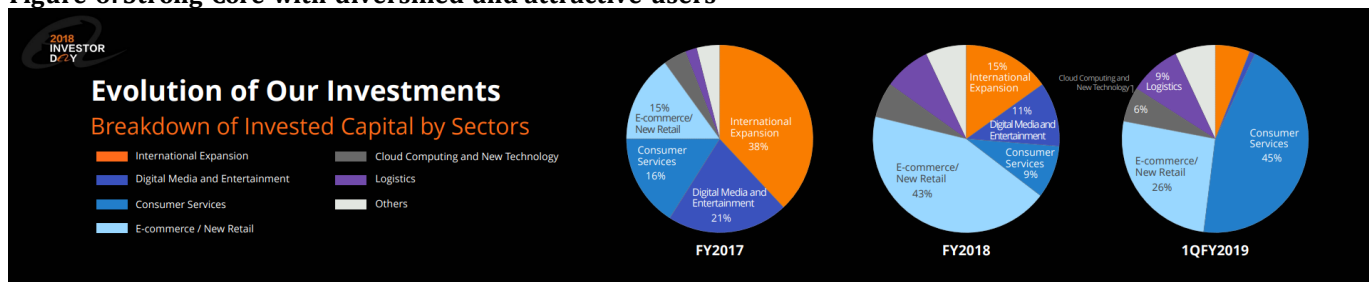


Source: Alibaba Investor Day 2018

## Joe Tsai (Executive Vice Chairman): Stepping up investment; Synergies created from M&A

Alibaba will step up investment on local services, New Retail, globalization, and techs, as Joe Tsai stated, thus still weigh on near-term margins. However, Alibaba has born initial fruits from synergies of investees (e.g. Youku). We expect more ecosystem synergies to be unlocked, and further optimizing efficiency and stimulating growth.

Figure 6: Strong Core with diversified and attractive users



Source: Alibaba Investor Day 2018

## Eyes on Chairman's retirement

Jack MA shared his views on retirement, Alibaba's outlook, trade war and China's economy. He regarded the succession plan as a throughout decision prepared for 10 years, to train young leaders to fight for Alibaba's sustainable growth. We believe Mr. Ma's upcoming retirement has limited impact on Ali's business operations, due to:

- 1) Daniel Zhang (current CEO) was highly-competent with working in Ali for 11 years. In the recent years, Daniel Zhang has already gradually taken charge of the company's daily operation as CEO, and his capability and initiatives is well-recognized.
- 2) There's a clear and well-prepared one-year transition period. During the transition period, Mr. Ma will still be involved into company governance as Chairman, and even after that he will still keep close contact with the management as a partner, and proactively participating in training young talents.
- 3) Alibaba Partnership to ensure healthy corporate government. Alibaba has already set up a mature partnership scheme to sustain the alignment of the corporate culture, and thus the governance strategy isn't expected to be fluctuated intensely after Mr. Ma's retirement.

For the trade war and China's economy, Mr. Ma expected short-term negative impact on both China and USA from trade war, but in the long run, trade war will promote China's economy upgrade from exporting to importing, thus benefiting Alibaba in the upcoming "upper-grade economy", in Mr. Ma's view.

Figure 7: Alibaba's Partnership



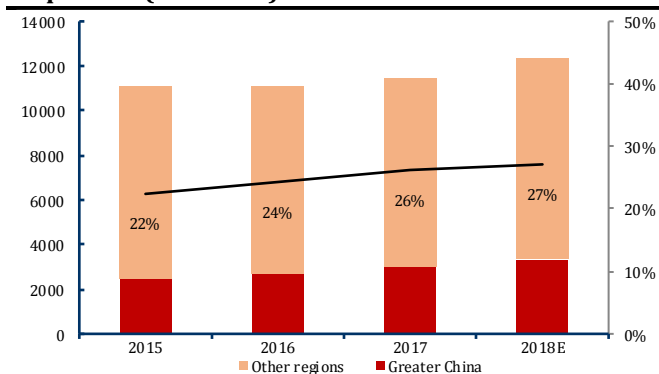
Source: Alibaba Investor Day 2018

## Cloud computing: Cornerstone of the future

### Pioneering the cloud computing business

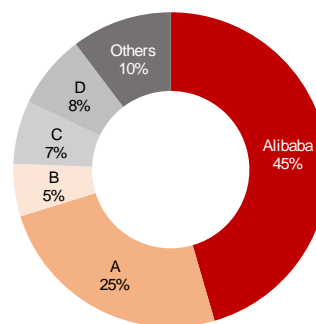
The booming of ecommerce and prevalence of IoT in China creates high demand for data infrastructure. According to Gartner report, China's cloud computing market accounts for 25% of the global market measured by annual server shipments in 2017, and was expected to maintain its strong momentum.

**Figure 8: Worldwide vs China annual server shipments (Unit:'000)**



Source: Gartner Forecast

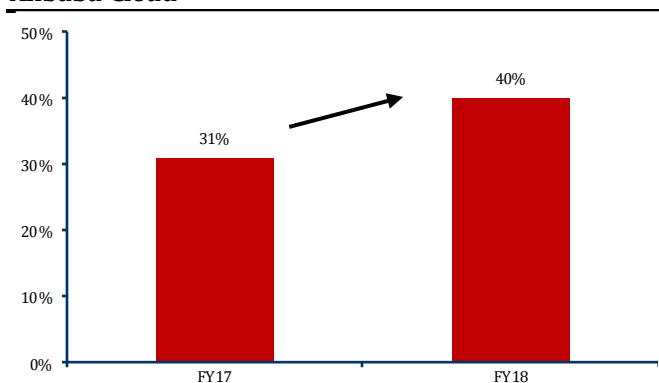
**Figure 9: China IaaS provider revenue market share in 2017**



Source: IDC Public Cloud Service Tracker

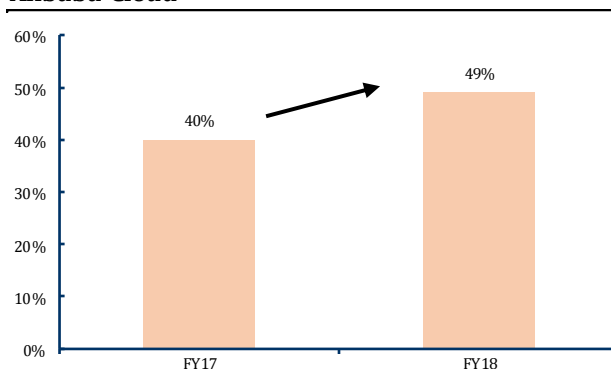
Alibaba has strengthened its leadership with its outstanding R&D capability and nonstop effort. Up to now, Alibaba has already become the hyper-scale IaaS providers with 45.5% market share in China in 2017, which equals the sum of the next 8 largest vendors, measured by revenue. Moreover, nearly half of China listed companies are utilizing the IT infrastructure provided by Alibaba to carry on operation optimization and business upgrade.

**Figure 10: 40% of China's Top 500 Companies are on Alibaba Cloud**



Source: Publicly available data, Alibaba Cloud

**Figure 11: 49% of China Listed Companies are on Alibaba Cloud**



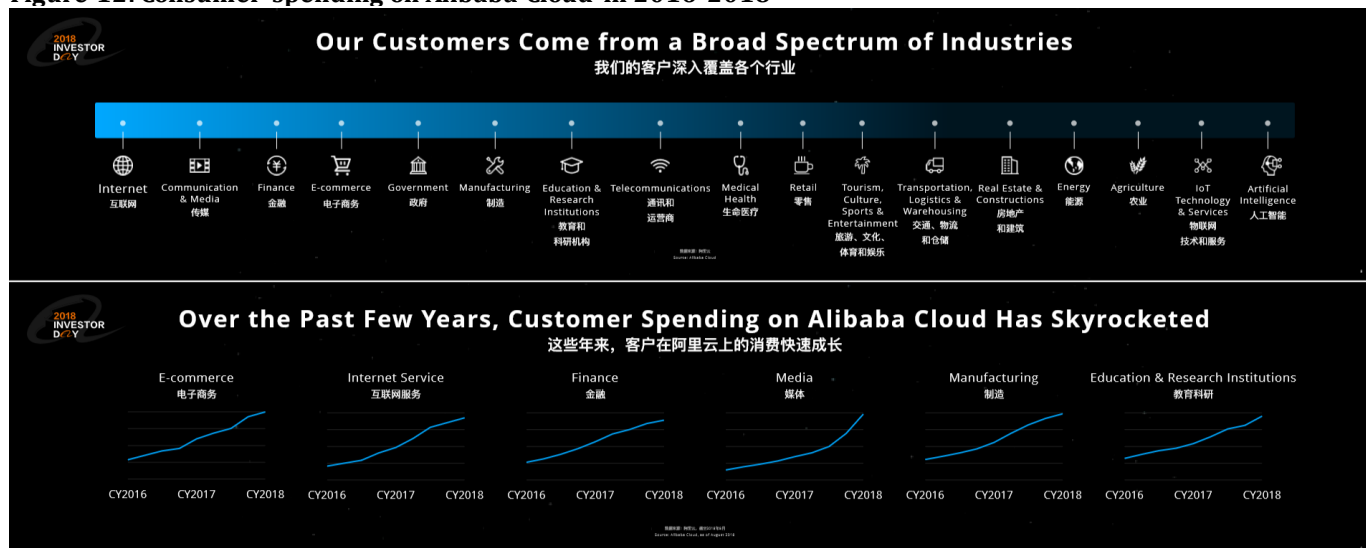
Source: Publicly available data, Alibaba Cloud



## Covering a broader spectrum of industries

AliCloud excelled itself with 1) lower cost; 2) stronger and stable performance in terms of computation, CDN, network, storage and database; and 3) high retention rate backed by wide geographic network coverage and technical barrier. With diversified service expansion, we expect AliCloud to attract more customers from a broader spectrum of industries. By leveraging its accumulated user data, Alibaba will also continuously expand its PaaS and SaaS solutions for deeper cooperation in the upcoming IoT era.

Figure 12: Consumer spending on Alibaba Cloud in 2016-2018



Source: Alibaba Investor Day 2018

Figure 13: Business as a Service Powered by Alibaba



Source: Alibaba Investor Day 2018

## Financial statements

### Income statement

Year end Mar 31 (Rmb mn)	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Turnover</b>	<b>101,143</b>	<b>158,273</b>	<b>250,266</b>	<b>400,420</b>	<b>552,878</b>	<b>718,164</b>
Core commerce	92,335	133,880	214,020	345,730	472,236	602,315
Cloud computing	3,019	6,663	13,390	25,039	43,556	70,934
Digital media and entertainment	3,972	14,733	19,564	25,042	31,002	37,274
Innovation initiatives and others	1,817	2,997	3,292	4,609	6,084	7,641
COSG	(34,355)	(59,483)	(107,044)	(203,013)	(287,496)	(373,445)
<b>Gross profit</b>	<b>66,788</b>	<b>98,790</b>	<b>143,222</b>	<b>197,407</b>	<b>265,381</b>	<b>344,719</b>
R&D	(13,788)	(17,060)	(22,754)	(42,044)	(55,288)	(71,816)
Sales and Marketing	(11,307)	(16,314)	(27,299)	(44,046)	(60,817)	(78,998)
Admin. Expense	(9,205)	(12,239)	(16,241)	(28,029)	(37,596)	(46,681)
Other income	(3,386)	(5,122)	(7,614)	(14,383)	(16,211)	(17,491)
<b>Operating profit</b>	<b>29,102</b>	<b>48,055</b>	<b>69,314</b>	<b>68,905</b>	<b>95,470</b>	<b>129,733</b>
Interest expenses	(1,946)	(2,671)	(3,566)	(3,923)	(4,315)	(4,746)
Associated	52,254	8,559	30,495	38,119	45,743	54,891
Exceptional items	2,058	6,086	4,160	1,000	1,000	1,000
<b>Pre-tax profit</b>	<b>81,468</b>	<b>60,029</b>	<b>100,403</b>	<b>104,101</b>	<b>137,898</b>	<b>180,877</b>
Results of equity investees	(1,730)	(5,027)	(20,792)	(20,274)	(20,274)	(20,274)
Tax	(8,449)	(13,776)	(18,199)	(23,423)	(31,027)	(40,697)
Minority interest	171	2,449	2,681	4,915	5,533	2,330
<b>Net profit</b>	<b>71,460</b>	<b>43,675</b>	<b>63,985</b>	<b>65,319</b>	<b>92,130</b>	<b>122,236</b>
Non-GAAP Adjustment	(28,498)	16,645	20,075	36,600	47,166	59,398
<b>Non-GAAP Net profit</b>	<b>42,962</b>	<b>60,320</b>	<b>84,060</b>	<b>101,919</b>	<b>139,296</b>	<b>181,634</b>

Source: Company, CMBIS estimates

### Balance sheet

Year end Mar 31 (Rmb mn)	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>230,210</b>	<b>324,296</b>	<b>460,269</b>	<b>544,281</b>	<b>624,287</b>	<b>702,051</b>
Fixed asset	13,629	20,206	66,489	113,863	146,160	173,612
Associated companies	91,461	120,368	139,700	139,700	139,700	139,700
Rents for land use-right	2,876	4,691	9,377	-	-	-
Intangible assets	87,015	139,528	189,614	235,630	283,339	333,650
Other non-current assets	35,229	39,503	55,089	55,089	55,089	55,089
<b>Current assets</b>	<b>134,035</b>	<b>182,516</b>	<b>256,855</b>	<b>271,659</b>	<b>324,521</b>	<b>426,984</b>
Cash	106,818	143,736	199,309	201,145	242,767	331,743
Account receivable	18,339	31,715	46,645	59,613	70,853	84,340
Other	8,878	7,065	10,901	10,901	10,901	10,901
<b>Current liabilities</b>	<b>52,039</b>	<b>93,771</b>	<b>135,810</b>	<b>156,101</b>	<b>176,393</b>	<b>200,742</b>
Borrowings	4,304	14,897	6,028	6,028	6,028	6,028
Trade and other payables	27,334	49,508	84,218	104,509	124,801	149,150
Current income tax liabilities	2,790	6,125	13,689	13,689	13,689	13,689
Amount due to associated parties	-	-	-	-	-	1
Other	17,611	23,241	31,875	31,875	31,875	31,874
<b>Non-current liabilities</b>	<b>62,317</b>	<b>88,920</b>	<b>141,875</b>	<b>141,875</b>	<b>141,875</b>	<b>141,875</b>
Borrowings	1,871	30,959	34,153	34,153	34,153	34,153
Deferred taxation	6,471	10,154	19,312	19,312	19,312	19,312
Other long-term liabilities	53,975	47,807	88,410	88,410	88,410	88,410
Mezzanine equity	350	2,992	3,001	3,001	3,001	3,001
<b>Total Equity</b>	<b>249,539</b>	<b>321,129</b>	<b>436,438</b>	<b>514,963</b>	<b>627,540</b>	<b>783,417</b>
Minority Interest	32,552	42,330	70,616	65,701	60,169	57,839
<b>Equity for common shareholder</b>	<b>216,987</b>	<b>278,799</b>	<b>365,822</b>	<b>449,262</b>	<b>567,371</b>	<b>725,579</b>

Source: Company, CMBIS estimates

## Cash flow summary

Year end Mar 31 (Rmb mn)	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Net income</b>	71,289	41,226	61,412	60,404	86,597	119,906
Depreciation and amortization	22,783	30,287	34,316	52,597	67,983	84,100
Change in working capital	10,454	9,923	38,936	20,291	20,291	24,350
Others	(47,690)	(1,110)	(9,493)	(8,873)	(6,263)	(7,552)
<b>Net cash from operating activities</b>	<b>56,836</b>	<b>80,326</b>	<b>125,171</b>	<b>124,420</b>	<b>168,608</b>	<b>220,804</b>
Capex	(10,845)	(17,546)	(118,582)	(122,584)	(126,986)	(131,828)
Associated companies	(24,209)	(67,692)	38,529	-	-	-
Other	(7,777)	6,874	(3,837)	-	-	-
<b>Net cash from investing activities</b>	<b>(42,831)</b>	<b>(78,364)</b>	<b>(83,890)</b>	<b>(122,584)</b>	<b>(126,986)</b>	<b>(131,828)</b>
Equity raised	693	14,607	-	-	-	-
Change of Debts	1,859	1,127	(17,818)	-	-	-
Dividend paid	-	-	-	-	-	-
Others	(18,398)	17,180	38,177	-	-	-
<b>Net cash from financing activities</b>	<b>(15,846)</b>	<b>32,914</b>	<b>20,359</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net change in cash</b>	<b>(1,841)</b>	<b>34,876</b>	<b>61,640</b>	<b>1,836</b>	<b>41,622</b>	<b>88,976</b>
Cash at the beginning of the year	108,193	106,818	143,736	199,309	201,145	242,767
Exchange difference	466	2,042	(6,067)	-	-	-
<b>Cash at the end of the year</b>	<b>106,818</b>	<b>143,736</b>	<b>199,309</b>	<b>201,145</b>	<b>242,767</b>	<b>331,743</b>
Pledge cash	-	-	-	-	-	-
<b>Cash at balance sheet</b>	<b>106,818</b>	<b>143,736</b>	<b>199,309</b>	<b>201,145</b>	<b>242,767</b>	<b>331,743</b>

Source: Company, CMBIS estimates

## Key ratios

Year end Mar 31	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>						
Core commerce	91.3	84.6	85.5	86.3	85.4	83.9
Cloud computing	3.0	4.2	5.4	6.3	7.9	9.9
Digital media and entertainment	3.9	9.3	7.8	6.3	5.6	5.2
Innovation initiatives and others	1.8	1.9	1.3	1.2	1.1	1.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Growth (%)</b>						
Revenue	92.6	56.5	58.1	60.0	38.1	29.9
Gross Margin	27.5	47.9	45.0	37.8	34.4	29.9
Operational Income	16.8	65.1	44.2	(0.6)	38.6	35.9
Adjusted Net Income	22.4	41.4	42.3	18.8	36.7	30.4
<b>Profitability (%)</b>						
Gross Margin	66.0	62.4	57.2	49.3	48.0	48.0
PreTax Margin	80.5	37.9	40.1	26.0	24.9	25.2
Tax Rate	(8.4)	(8.7)	(7.3)	(5.8)	(5.6)	(5.7)
Net Profit Margin	70.5	26.0	24.5	15.1	15.7	16.7
Adjusted Net Profit Margin	42.1	38.1	34.3	25.5	25.2	25.3
<b>Balance sheet ratios</b>						
Current ratio (x)	2.6	1.9	1.9	1.7	1.8	2.1
Debtors turnover days	54.1	53.1	52.7	45.3	40.8	37.7
Creditors turnover days	250.6	228.6	218.8	164.2	141.7	130.9
Inventory turnover days	-	-	-	-	-	-
Net debt / equity ratio (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
<b>Returns (%)</b>						
ROE	17.1	18.6	19.5	19.7	22.1	23.1
ROA	11.7	11.4	11.6	11.9	14.1	15.9
<b>Per share data</b>						
Adjusted EPS (Rmb)	16.6	23.4	32.9	38.9	52.8	68.2
DPS (Rmb)	-	-	-	-	-	-
BVPS (Rmb)	97.5	126.0	168.4	197.5	239.2	295.4

Source: Company, CMBIS estimates



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<b>BUY</b>	: Stock with potential return of over 15% over next 12 months
<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
<b>SELL</b>	: Stock with potential loss of over 10% over next 12 months
<b>NOT RATED</b>	: Stock is not rated by CMBIS

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