Alibaba: You Can't Keep Ignoring It

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Summary

- Alibaba's stock is plummeting 4% despite beating revenue and EPS estimates in Q3 and increasing its buyback plan by $25 billion.
- Slow growth in the Taobao, Tmall, and Cloud segments is causing pessimism, but the Chinese government's expansionary monetary policy and potential economic recovery could benefit Alibaba.
- The International Digital Commerce segment is performing well, with a 44% increase in revenue, and other segments, such as Cainiao and Local Services, are also experiencing growth.

Wang HE/Getty Images News

Alibaba's December Quarter 2023 has just been released, and at the time I am writing this article, the stock is already plummeting 4%. Apparently, within the presentation, the word "AI" was not mentioned endlessly and unrealistic market cap targets were not defined.

Investors are still too pessimistic about the Chinese stock market, which is why any news now seems like a reason to sell Alibaba (NYSE:BABA). Still, both revenue and EPS estimates were beaten this quarter:

- Q3 Non-GAAP EPADS of $2.67 beats by $0.03.
- Revenue of $36.67B (+2.1% Y/Y) beats by $270M.

In addition, the buyback plan was increased by $25 billion and is on top of the remaining $10.30 billion. Personally, I remain rather puzzled by the market reaction but my view toward this company remains the same as in my last article: at the current price Alibaba does not make sense, it is too undervalued.

Highlights December Quarter 2023

(in RMB Mn, except per share data and percentages)	Three months ended Dec 31,			Nine months ended Dec 31,		
	2022	2023	YoY%	2022	2023	YoY%
Taobao and Tmall Group	127,065	129,070	2%	323,317	341,677	6%
Cloud Intelligence Group	27,364	28,066	3%	78,755	80,779	3%
Alibaba International Digital Commerce Group	19,824	28,516	44%	51,591	75,150	46%
Cainiao Smart Logistics Network Limited	23,023	28,476	24%	58,597	74,463	27%
Local Services Group	13,397	15,160	13%	37,909	45,174	19%
Digital Media and Entertainment Group	4,261	5,040	18%	13,455	16,200	20%
All others[1]	50,334	47,023	(7)%	143,812	140,873	(2)%
Total segment revenue	**265,268**	**281,351**	**6%**	**707,436**	**774,316**	**9%**
Unallocated	225	374		634	900	
Inter-segment elimination	(17,737)	(21,377)		(47,583)	(55,922)	
Consolidated revenue	**247,756**	**260,348**	**5%**	**660,487**	**719,294**	**9%**
Income from operations	**35,031**	**22,511**	**(36)%**	**85,111**	**98,585**	**16%**
Share-based compensation expense	8,773	6,222		23,285	11,423	
Amortization and impairment of intangible assets	5,530	14,601		11,010	19,511	
Impairment of goodwill, and others	2,714	9,509		3,225	11,540	
Net income	**45,746**	**10,717**	**(77)%**	**43,577**	**70,413**	**62%**
Diluted earnings per share[2][3]	**2.24**	**0.71**	**(68)%**	**2.31**	**3.72**	**61%**
Diluted earnings per ADS[2][3]	**17.91**	**5.65**	**(68)%**	**18.49**	**29.73**	**61%**
Non-GAAP Measures						
Adjusted EBITA	**52,048**	**52,843**	**2%**	**122,631**	**141,059**	**15%**
Non-GAAP net income	**49,932**	**47,951**	**(4)%**	**114,004**	**133,061**	**17%**
Non-GAAP diluted earnings per share[2][4]	**2.41**	**2.37**	**(2)%**	**5.48**	**6.50**	**19%**
Non-GAAP diluted earnings per ADS[2][4]	**19.26**	**18.97**	**(2)%**	**43.80**	**51.97**	**19%**

Alibaba December Quarter 2023 Results

The core business segment driven by *Taobao* and *Tmall* generated RMB 129.07 billion, up 2% quarter-on-quarter and 6% based on the last three quarters. The Cloud segment generated RMB 28.06 billion, up 3% from the previous quarter and 3% based on the last nine months.

Together, these two segments are critically important to Alibaba, in fact they are responsible for 59% of revenue. Investors probably expected more growth from them, which would explain the drop in the price per share. In any case, if this was the cause of the pessimism, I think the market is not taking into account a number of important factors:

- The first is that China is facing a difficult period; in fact, it is struggling with deflation. Since most of Alibaba's revenue comes from China, we cannot expect exorbitant growth rates: even low growth is not bad. Once the business cycle is reversed, Alibaba will benefit from the country's economic recovery. Certainly competitors like Pinduoduo are gaining momentum in e-commerce, but the slow revenue growth is mainly due to the country's difficult times.

- The recovery of China and Alibaba may come sooner than expected. In recent months the government has begun to apply a more expansionary monetary policy, and a few days ago the Chinese sovereign wealth fund announced that it will continue to increase holdings in China ETFs. The aim is to regain investor confidence and give the Chinese stock market a boost.

So, while it is true that *Taobao*, *Tmall* and the Cloud are growing too slowly, there is a basis for something to change as early as the next few quarters. It will certainly not be an easy path to make the Chinese stock market attractive again, but it is certainly not impossible.

Having discussed earnings from China, let us now take a look at what is happening to international earnings.

(in RMB Mn, except percentages)	Three months ended Dec 31, 2022	2023	YoY %	Nine months ended Dec 31, 2022	2023	YoY %
International commerce retail	14,954	23,260	56%	36,686	59,376	62%
International commerce wholesale	4,870	5,256	8%	14,905	15,774	6%
Revenue	**19,824**	**28,516**	**44%**	**51,591**	**75,150**	**46%**
Adj. EBITA	**(645)**	**(3,146)**	**(388)%**	**(2,773)**	**(3,950)**	**(42)%**

Alibaba December Quarter 2023 Results

The International Digital Commerce segment reached RMB 28.51 billion, up 44% from the previous quarter and 46% compared to the first nine months of FY 2023. In short, Alibaba has achieved an excellent performance and is increasingly expanding its market share in the West. In particular, *AliExpress* achieved a 60% increase in orders over last year despite Pinduoduo's strong competition with *Temu*. Management's goal is to try to increase revenues in this segment as much as possible without giving too much weight to profitability. In other words, it is the orders placed that matter more than the profit per order. The main thing today is to spread out as much as possible, and only then to think about profitability.

For this reason, Adj. EBITDA underperformed, in fact the loss increased to RMB 3.14 billion. Much of it was due to the huge investments to improve *AliExpress*.

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Taobao and Tmall Group	**127,065**	**129,070**	**2%**	**323,317**	**341,677**	**6%**
China commerce retail	122,736	123,762	1%	309,595	326,150	5%
- Customer management	91,694	92,113	0%	230,996	240,435	4%
- Direct sales and others[1]	31,042	31,649	2%	78,599	85,715	9%
China commerce wholesale	4,329	5,308	23%	13,722	15,527	13%
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Alibaba December Quarter 2023 Results

In addition to International Digital Commerce, other segments also achieved excellent growth, both on a quarterly basis and on the basis of the first three quarters:

- *Cainiao* is Alibaba's logistics system and is improving quarter after quarter. To support the development of cross-border business, *Cainiao* has further expanded the coverage of the premium 5-day delivery service; in fact, two more countries have been added. In addition, order volume for this premium service achieved triple-digit growth over the previous quarter. In terms of revenue, *Cainiao* generated RMB 28.47 billion, up 24% from the previous quarter and 27% from the first nine months of FY2023.

- Local Services generated revenues of RMB 15.16 billion, up 13% from the previous quarter and 19% from the first nine months of FY2023. Active consumers have reached 390 million and their purchase frequency is increasing year on year. This business segment is still unprofitable, but losses are shrinking as economies of scale increase.

- Digital Media and Entertainment Group is the division of Alibaba that deals with movie production/distribution as well as event organization. In the last quarter, Alibaba Pictures managed to consolidate its leading position by serving almost all major concerts in China. In terms of revenues, growth here was also rapid: 18% over the previous quarter and 20% over the first nine months of 2023.

Overall, revenues this quarter were RMB 260.34 billion, up 6% from the same quarter in FY2023 and 9% considering the first nine months. Operating income was RMB 22.51 billion, down 36% from the same quarter of FY2023 but up 16% counting the first nine months. In short, beyond a good quarterly, FY2024 does not seem to be performing as poorly as the price per share would suggest. Despite a thousand criticisms, revenues continue to grow and also operating income by broadening the frame of reference.

Finally, I would like to highlight the cash inflows generated in the first three months of FY2024.

	Three months ended Dec 31,			Nine months ended Dec 31,		
	2022	2023		2022	2023	
Cash Flow	RMB Mn	RMB Mn	USD Mn	RMB Mn	RMB Mn	USD Mn
Net cash provided by operating activities	87,370	64,716	9,115	168,351	159,253	22,430
Less:						
Purchase of property and equipment (excluding land use rights and construction in progress relating to office campuses)	(5,793)	(7,286)	(1,026)	(27,860)	(17,405)	(2,451)
Purchase of intangible assets (excluding those acquired through acquisitions)	-	(842)	(119)	(22)	(842)	(119)
Changes in the buyer protection fund deposits	(63)	(48)	(7)	(1,073)	(157)	(22)
Free cash flow	81,514	56,540	7,963	139,396	140,849	19,838
Net cash outflow relating to capital expenditure	(6,897)	(8,857)	(1,247)	(30,852)	(20,934)	(2,948)
Net cash inflow (outflow) from investment and acquisition activities[1]	1,890	(1,500)	(211)	(2,318)	3,289	463
Share Repurchase	(24,455)	(20,706)	(2,916)	(62,135)	(54,731)	(7,709)

Alibaba December Quarter 2023 Results

So far, the free cash flow generated in FY2024 has been $19.83 billion. Alibaba's current capitalization is about $190 billion, which assumes a Market Cap/FCF ratio of only 9.58x. But I am not considering that there is still one quarter left until the end of FY2024 and Alibaba has a net debt of about -$50 billion. In short, the current valuation is completely irrational and even if Alibaba were to stop growing it would still be undervalued. Although sentiment is getting worse and worse, my view toward this company remains unchanged.

Conclusion

Alibaba continues to fail to impress investors, despite the fact that revenues are returning to growth as well as operating income based on the first nine months of FY2024. Arguably, even if it had beaten analysts' estimates by a lot there would still have been a reason to consider this quarter negatively. The sentiment of distrust is too great and goes beyond any number. In any case, I think sooner or later the market will realize that it is making a big misjudgment: it cannot continue to ignore Alibaba forever.

The Chinese Monetary Fund is increasing purchases of ETFs and the Chinese government is pushing a more expansionary monetary policy than in the past. New liquidity in the system is a key driver for a country's stock market, and we know this very well after what the Fed did in 2020. In addition, Alibaba itself will be a further driver of growth in its price per share: an additional $25 billion has been allocated for the buyback and is on top of the previous $10.30 billion.

The potential for a $35.30 billion buyback with the price per share around $75 is huge and could reduce the shares outstanding quite a bit. Management could even increase this figure during the coming quarters, after all Alibaba in the last nine months has generated $19.83 billion in free cash flow and has no debt. All this would give a big boost to both EPS and dividend per share.

Overall, even though there is still a lot of pessimism the company continues to make money and that is the most important thing. The prospects for growth remain good, both within China once the country's economic recovery takes place and internationally. Alibaba cannot be undervalued forever.

This article was written by

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Passionate about financial markets, I express my opinion on Seeking Alpha about the economy in general and individual companies.

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