Alibaba Q3 Earnings: Good Enough For Us To Stay Bullish

Feb. 09, 2024 11:02 AM ET**Alibaba Group Holding Limited (BABA) Stock**BABAF15 Comments11 Likes

Dan Victor, CFA
Investing Group Leader
Follow

Summary

- Alibaba's Q3 Earnings beat estimates, while the company announced a new $25 billion share buyback program.
- Despite soft growth amid volatile macro conditions in China, Alibaba remains profitable and generates significant free cash flow.
- We are bullish on the stock with an expectation that improving sentiment toward the region supports a positive long-term outlook.
- I am Dan Victor, CFA, president of Posto Asset Management. I offer exclusive market commentary and tactical trade ideas. I run the investing group Conviction Dossier, where I help investors stay ahead of market trends and inflection points.

Andrew Burton

Alibaba Group Holdings' (NYSE:BABA) latest quarterly results beat estimates, but fell short of turning the page on a backdrop of terrible sentiment. At least the market wasn't too impressed as shares fell more than 5% on the news. The Chinese e-commerce and cloud computing giant has been in a rut over the last several years, and it's clear to us it will likely take a bit more time and stronger results to completely rebuild investor confidence.

On the other hand, the group remains highly profitable, and the latest trends suggest some encouraging signs of an operational turnaround. Despite poor macro data out of China, the bigger picture still supports an expectation for conditions to improve going forward.

In our view, this report from BABA was good enough to help stabilize the outlook. Shares are still up from a January low, which can represent "the bottom" ahead of a gradual rally higher through 2024. We believe BABA remains undervalued, with a large new share buyback program working as a tailwind of support.

Data by YCharts

BABA Q3 Earnings Recap

BABA fiscal 2024 Q3 non-GAAP EPADS of $2.67, came in $0.03 ahead of the consensus, while down -2% year-over-year. Revenue of RMB 260 billion, or $36.7 billion, climbed by 5% y/y and was also above the $36.4 billion forecast.

There are several moving parts here, but the context of the softer earnings reflects a shifting business mix even as steps have been taken to control expenses. Normalized adjusted EBITDA of $8.4 billion, up 1% y/y, paints a more favorable picture of the underlying financial stability.

	Three months ended December 31,			
	2022	2023		
	RMB	RMB	US$	YoY % Change
	(in millions, except percentages and per share amounts)			
Revenue	247,756	260,348	36,669	5%
Income from operations	35,031	22,511	3,171	(36)%[2]
Operating margin	14%	9%		
Adjusted EBITDA[1]	59,162	59,572	8,391	1%[3]
Adjusted EBITDA margin[1]	24%	23%		
Adjusted EBITA[1]	52,048	52,843	7,443	2%[3]
Adjusted EBITA margin[1]	21%	20%		
Net income	45,746	10,717	1,509	(77)%[4]
Net income attributable to ordinary shareholders	46,815	14,433	2,033	(69)%[4]
Non-GAAP net income[1]	49,932	47,951	6,754	(4)%[4]
Diluted earnings per share[5]	2.24	0.71	0.10	(68)%[4][6]
Diluted earnings per ADS[5]	17.91	5.65	0.80	(68)%[4][6]
Non-GAAP diluted earnings per share[1][5]	2.41	2.37	0.33	(2)%[4][6]
Non-GAAP diluted earnings per ADS[1][5]	19.26	18.97	2.67	(2)%[4][6]

source: company IR

Within the top-line figure, China commerce retail sales covering the "Taobao" and "Tmall" platforms were up by 1%, between flat marketplace fulfillment and a 2% increase in direct sales.

Notably, management explains that while gross merchandise value (GMV), with the number of transactions and order volumes "growing strongly", average order value has offset some of those gains. Part of the strategy is to broaden the assortment with a wider range of brands and products that have shifted some of the economics but are expected to support stronger long-term growth.

The traditionally more profitable Cloud Intelligence Group posted a modest 3% revenue increase. While far from the growth momentum benchmarks achieved by U.S. cloud services leaders, Alibaba explains an effort to limit low-margin contracts and focus on larger deals, which has dragged the revenue number but is already adding to a profitability improvement.

Favorably, the International Digital Commerce segment that includes sites like "AliExpress", "Lazada", and Turkey's "Trendyol" was a strong point this quarter with revenues up 44%. Now representing more than 10% of the overall business, this climbing diversification helps to add a layer of quality to the group's profile.

Smaller segments like logistics and the digital entertainment group have also been growth drivers. While management is not providing formal financial guidance, the priority is to "reignite growth" looking across the core segments through 2024.

	Three months ended December 31,			
	2022	2023		
	RMB	RMB	US$	YoY % Change
		(in millions, except percentages)		
Taobao and Tmall Group:				
China commerce retail				
- Customer management	91,694	92,113	12,974	0%
- Direct sales and others[2]	31,042	31,649	4,458	2%
	122,736	123,762	17,432	1%
China commerce wholesale	4,329	5,308	747	23%
Total Taobao and Tmall Group	127,065	129,070	18,179	2%
Cloud Intelligence Group	27,364	28,066	3,953	3%
Alibaba International Digital Commerce Group:				
International commerce retail	14,954	23,260	3,276	56%
International commerce wholesale	4,870	5,256	740	8%
Total Alibaba International Digital Commerce Group	19,824	28,516	4,016	44%
Cainiao Smart Logistics Network Limited	23,023	28,476	4,011	24%
Local Services Group	13,397	15,160	2,135	13%
Digital Media and Entertainment Group	4,261	5,040	710	18%
All others[3]	50,334	47,023	6,623	(7)%
Total segment revenue	**265,268**	**281,351**	**39,627**	**6%**
Unallocated	225	374	53	
Inter-segment elimination	(17,737)	(21,377)	(3,011)	
Consolidated revenue	**247,756**	**260,348**	**36,669**	**5%**

source: company IR

We mentioned the share repurchasing announcement. Alibaba is upping its existing authorization by $25 billion to a current authorization of $35.3 billion through March 2027. Considering the current market cap of around $195 billion, the implied buyback yield over the next three years is 18%.

That amount is well covered by a current $92 billion in cash, against $23 billion in financial debt. We believe the balance sheet is a strong point in the company's investment profile. That dynamic is supplemented by underlying free cash flow reaching an annualized run rate of $32 billion this past quarter.

Cash Flow & Balance Sheet: Selected Financials

Alibaba

	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)**

	As of Mar 31,	As of Dec 31,	
	2023	2023	
Balance Sheet	RMB Mn	RMB Mn	USD Mn
Cash and cash equivalents	193,086	254,804	35,889
Short-term investments	326,492	300,419	42,313
Other treasury investments	40,736	97,739	13,766
Cash balance	**560,314**	**652,962**	**91,968**
Less:			
Current and non-current bank borrowings	(59,489)	(65,430)	(9,215)
Current and non-current unsecured senior notes	(101,865)	(100,496)	(14,155)
Net cash position	**398,960**	**487,036**	**68,598**

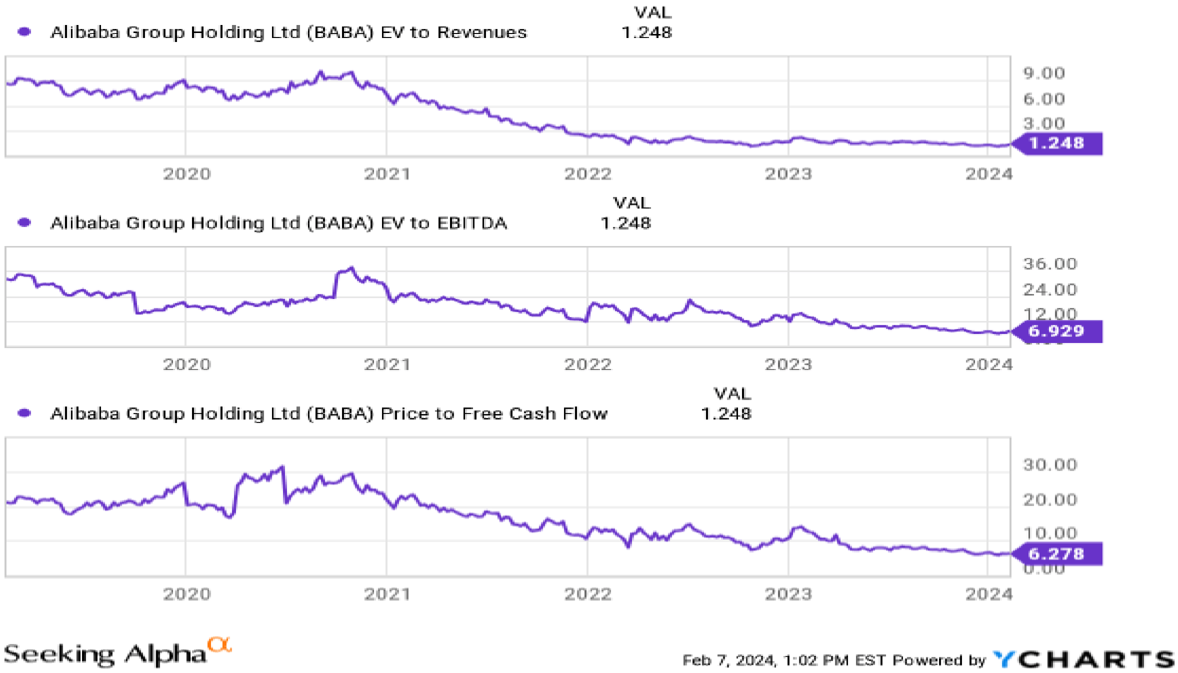
source: company IR

What's Next For Alibaba?

When looking at Alibaba, the challenge here is to escape the pessimism surrounding China which has faced not only weaker-than-expected growth, but a long-running risk aversion by foreign investors. Headlines of large-scale real estate defaults and even international companies citing China as an area of consumer spending weakness have kept the situation volatile.

The sense is that the economic engine has slowed, forcing policymakers to move forward with new stimulus measures. Recent steps announced by the government include efforts to encourage lending as well as talk of a larger scale financial system rescue package are a start, but there doesn't seem to be a quick fix insight.

At the same time, it's hard to ignore what we believe is compelling underlying value, considering the massive repricing and reset of expectations over the last several years. In our opinion, BABA trading at 1.2x revenue or 6x free cash flow today is a completely different opportunity compared to the company's profile as a high-growth name that commanded a significantly higher premium three or four years ago.



Data by YCharts

The upside for BABA will need the narrative surrounding China to improve, which should carry over into a potentially significant expansion of valuation multiples.

We've seen this before, specifically thinking back to October 2022 when the U.S. stock market hit its cycle low, at a time when analysts were jumping over themselves to lower estimates and predict even more downside. What ended up happening is from a gradual few steps higher, the narrative can change quickly for the better and end up surprising a lot of people.

With BABA, even with this post-earnings selloff, shares remain well above its recent low of under $68.00 which we believe should hold. It won't be a straight line higher, but the potential to reclaim a four-month-high above $80.00 over the next few weeks can kickstart a new round of bullish momentum.

The backdrop here into 2024 is one of a resilient global economy, with the U.S. data stronger than expected is supportive of China trade flows. We've already seen some of that with an uptick in the China manufacturing PMI that could preview a strengthening country-level consumer indicators as a tailwind for sentiment.

source: StockCharts

Final Thoughts

We rate BABA as a buy, with the takeaway from this latest quarterly report that the trends are good enough to stay bullish. Over the next several quarters, we'll want to see the group continue delivering on financial efficiency and ultimately generate stronger growth, particularly from the core China commerce segment. Monitoring points include the operating margin and cash flow trends.

In terms of risks, beyond a more concerning deterioration of the Chinese economy, investors should be aware of headlines related to the regulatory environment or potential trade protections that could impact Alibaba's growth opportunities.

Editor's Note: This article discusses one or more securities that do not trade on a major U.S. exchange. Please be aware of the risks associated with these stocks.