



Alibaba (BABA US/9988 HK)

Intact medium term outlook

- Decent 4Q19 results with 53% YoY increase in non-GAAP net profit and 38% revenue growth
- Short-term logistics hiccup amid coronavirus outbreak but medium term outlook remain intact
- Maintain **BUY** on leading market position in the ecommerce market

4Q19 highlight. Alibaba reported a decent set of result in 4Q19. Revenue grew by 38% YoY to RMB161.5bn, while non-GAAP net profit rose by 53% YoY to RMB48.6bn. Gross margin improved sequentially from 44.9% in 3Q19 to 47.8% in 4Q19, while core net margin improved to 30.1% in 4Q19 versus 29.0% in 3Q19.

Impact from coronavirus outbreak. Overall, business was impacted after CNY due to disturbances of logistics in various regions amid current coronavirus outbreak, which could potentially impact its upcoming 1Q19 results, in our view. On a positive note, we believe the potential full-year impact to FY3/21 could be more manageable as major logistics companies have begun to resume operations in recent days. In addition, the company could potentially benefit from consumption shifting from offline to online especially for groceries and food products.

Intact medium term outlook. Looking beyond the short-term hiccup, Alibaba's fundamental outlook remains intact, in our view. We continue to like Alibaba's leading market position in the ecommerce sector, with ongoing market share gains. In addition, Alibaba has been transforming its business from an online distribution platform to a technology enabler for online merchants via effective use of A.I. and big data technology.

Valuation and recommendation. We maintain **BUY** on its leading market position in the ecommerce sector. Our TP for **Alibaba-H (9988 HK)** and **Alibaba-ADR (BABA US)** are HK\$251 and USD258 respectively.

Risk factors: 1) Regulatory action on cloud computing in overseas market; 2) Tightening regulation on internet finance; 3) Intensified competition; 4) Slowdown in ecommerce; 5) No dividend record to ordinary shareholders.

Results and Valuation

FY end Mar 31	FY18A	FY19A	FY20E	FY21E
Revenue (RMB mn)	250,266	376,844	502,356	639,174
Chg (% YoY)	58.1	50.6	33.3	27.2
Net profit (RMB mn)	63,985	87,600	147,397	100,408
Chg (% YoY)	46.5	36.9	68.3	(31.9)
Core net profit (RMB mn)	85,766	100,731	130,919	154,722
Chg (% YoY)	42.2	17.4	30.0	18.2
Underlying EPS (RMB)	3.1	4.2	6.9	4.7
Chg (% YoY)	43.0	35.5	61.8	(31.9)
Core EPS (RMB)	4.2	4.9	6.1	7.2
Chg (% YoY)	38.8	16.2	25.0	18.2
Core P/E (x)- ADR	46.8	39.9	31.5	26.7
Core P/E (x)-H share	46.6	39.9	31.4	26.6
ROAE (%)	16.9	16.8	21.1	11.6
ROAA (%)	10.5	10.4	13.7	7.8

*1 ADR = 8 ordinary shares

Source (s): Bloomberg, ABCI Securities estimates

Company Report

Rating (ADR): BUY
TP (ADR): USD 258
Rating (H-share): BUY
TP (H-share): HK\$ 251

Analyst : Steve Chow
Tel: (852) 2147 8809
stevechow@abci.com.hk

Price (ADR/H-share)	USD 220.3/ HK\$215.2
Est. share price return (ADR/H-share)	17.3%/16.3%
Est. dividend yield (ADR/H-share)	NA/NA
Est. total return (ADR/H-share)	17.3%/16.3%
Last Rating & TP (ADR/H-share)	BUY, USD258/ BUT, HK\$251

Previous Report Date Jan 15, 2020

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L (HK\$) (H-share)	
52Wk H/L (USD) (ADR)	
Issued shares (mn)	21,462
Market cap (HK\$ mn) (H-share)	4,618,407
Market cap (USD mn) (ADR)	591,143
3-mth avg daily turnover (HK\$ mn) (H-share)	
3-mth avg daily turnover (USD mn) (ADR)	
Major shareholder(s) (%):	
Softbank	25.1%
Jack Ma	6.0%
Joseph Tsai	1.9%

Source(s): Bloomberg, ABCI Securities



4Q19 highlight

Overall, Alibaba reported a decent set of result in 4Q19. Revenue grew by 38% YoY to RMB161.5bn, largely in line with market expectation.

Core commerce revenue growth remained resilient at 38% YoY in 3Q19. Tmall online physical goods GMV growth remained solid at 24% YoY in 4Q19 with strong growth in fast-moving consumer goods and consumer electronics. In addition, local consumer service (mainly Ele.me) experienced decent revenue growth of 47% YoY in 4Q19 driven by ongoing penetration into less developed areas and synergies with Ant Financial.

On the other hand, cloud computing continued to experience rapid revenue growth of 62% YoY in 4Q19 driven by both public cloud and hybrid cloud businesses.

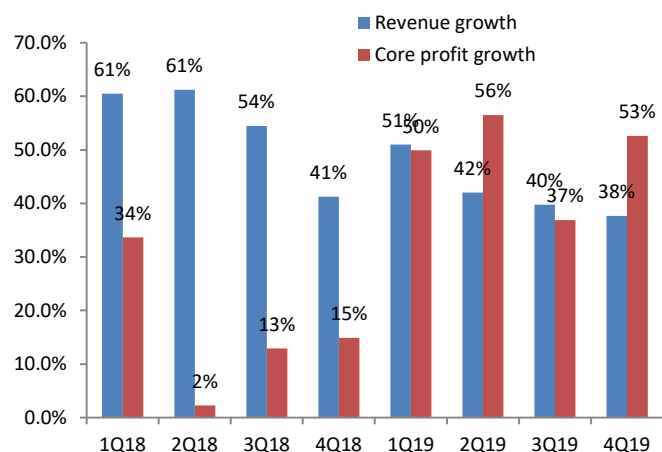
Non-GAAP net profit, on the other hand, rose by 53% YoY to RMB48.6bn, 16% higher than market expectation thanks to cost control and economy of scale.

Gross margin improved sequentially from 44.9% in 3Q19 to 47.8% in 4Q19, while core net margin improved to 30.1% in 4Q19 versus 29.0% in 3Q19.

Overall, business was impacted after CNY due to disturbances of logistics in various regions amid current coronavirus outbreak, which could impact its upcoming 1Q19 (4QFY3/20) results.

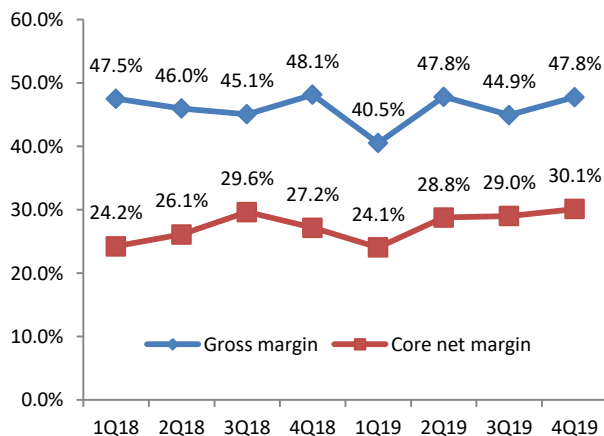
On a positive note, we believe the potential full-year impact to FY3/21 (starting in April 2020) could be more manageable as the logistics industry gradually resumes operations in coming months.

Exhibit 1: Alibaba's growth trend



Source(s): Company

Exhibit 2: Alibaba's margin trend



Source(s): Company



Maintain BUY on intact medium term outlook

We maintain our BUY recommendation on the counter given its leading market position in the e-commerce sector and intact medium term industry outlook.

We derive Alibaba's TP based on SOTP approach, as shown in the below table.

For Alibaba's core business, we apply target multiple of 29x on its FY3/21E core profit. For its strategic investments, we apply 10% discount to the book values.

Alibaba-H (9988 HK): The SOTP approach results in a TP HK\$ 251.

Alibaba-ADR (BABA US): Based on our TP of Alibaba-H, we set the corresponding TP of Alibaba-ADR to be US\$ 258 (1 ADR represents 8 shares).

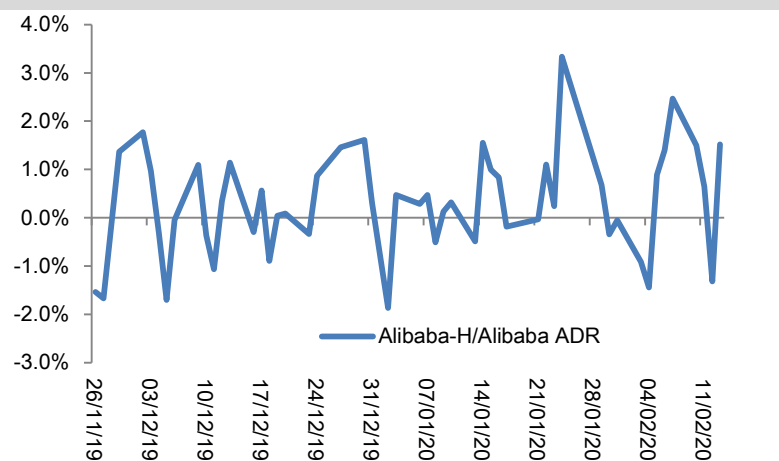
Exhibit 3: SOTP-based TP

(HKD per share)	TP	Remarks
Core business	235	29x FY21E core profit
Strategic investments	16	10% holding discount on book value
Total	251	

Source(s): Companies, Bloomberg, ABCI Securities estimates

Overall, Alibaba's H-share/ADR price different since the listing of Alibaba-H in late-Nov 2019 is generally below 2.0% with an average of just 0.3%. In our view, this indicates that the HK/US markets are largely efficient with limited arbitrage opportunities between the two counters.

Exhibit 4: Price difference between Alibaba-H and Alibaba-ADR



*One ADR represents eight ordinary shares

Source(s): Bloomberg, ABCI Securities



Exhibit 5: 4Q19 review

(RMB m)	4Q18	4Q19	YoY %	Remarks
Core commerce	102,843	141,475	38%	Driven by new businesses such as local services, new retail, etc.
Cloud computing	6,611	10,721	62%	
Others	7,824	9,260	18%	
Total revenue	117,278	161,456	38%	
Cost of sales	-60,813	-84,332	39%	
Gross profit	56,465	77,124	37%	
Product development expenses	(8,901)	(11,077)	24%	
Selling & marketing expenses	(12,104)	(15,800)	31%	
General & admin expenses	(5,853)	(7,415)	27%	
Amortization/Impairment	(2,809)	(3,272)	16%	
Operating Profits	26,798	39,560	48%	
Interest and investment income	11,560	17,136	48%	
Interest expenses	(1,334)	(1,309)	-2%	
Other income	387	987	155%	
Share of results of equity investees	(861)	2,165	-351%	
Profit before tax	36,550	58,539	60%	
Tax	(5,586)	(8,407)	51%	
Profit after tax	30,964	50,132	62%	
Minority interests	2,156	2,042	-5%	
Net profit	33,120	52,174	58%	
Non-GAAP net profit	31,869	48,638	53%	
Profitability:	4Q18	4Q19		
Gross margin	48.1%	47.8%		Sequential margin improvement
Net margin	28.2%	32.3%		
Non-GAPP net margin	27.2%	30.1%		

*4Q19= 3-month period ended at Dec 2019

Source(s): Company



Exhibit 6: Forecast changes

	FY3/20			
(RMB m)	old	new	Diff	Comment
Revenues	502,356	502,356	0%	
Net income	144,506	147,397	2%	Lower cost assumptions
Core profit	128,023	130,919	2%	

Source(s): ABCI Securities estimates



Risk factors

Regulatory action on cloud computing in overseas market

As the Group operates cloud computing data centers in various overseas market, including Indonesia, Malaysia, India, Australia, Singapore, Germany, Japan, the US and others. Any tightened local regulations in cloud computing would impact its cloud computing operation. In FY3/19, cloud computing accounted for 7% of total revenue.

Tightening regulation on internet finance

As the Group is exposed to the internet finance market via Ant Financials, any tightened regulatory measures in the internet finance market would impact financial performance

Market competition

The Group competed with other online ecommerce platforms, in particular JD.com. The competition will be on commission rate, promotion discount, brand advertising, technological investment, etc.

In particular, we expect competition to intensify if major overseas online platforms, such as Google and Facebook, are allowed to enter the China market.

Slowing of ecommerce consumption

As the Group is exposed to consumer spending on services, any significant slowdown of consumption in China would impact financial performance. In the long term, we believe domestic market growth would converge with income growth, which is usually in line with GDP growth.

No dividend record to ordinary shareholders

The Group has omitted dividend to ordinary shareholders since listing.

Non-GAAP profit

Non-GAAP profits are for reference to ease comparison. It is substantially different from the reported net profit.



Consolidated income statement (FY18A-FY21E)

FY Ended Mar 31 (RMB mn)	FY18A	FY19A	FY20E	FY21E
Core commerce	214,020	323,400	425,002	526,103
Cloud computing & Internet infrastructure	13,390	24,702	39,523	63,237
Others	22,856	28,742	37,831	49,834
Total revenue	250,266	376,844	502,356	639,174
Cost of sales	(107,044)	(206,929)	(271,976)	(349,245)
Gross profit	143,222	169,915	230,380	289,928
Product development expenses	(22,754)	(37,435)	(48,686)	(63,225)
Selling & marketing expenses	(27,299)	(39,780)	(53,043)	(70,686)
General & admin expenses	(16,241)	(24,889)	(28,179)	(35,854)
Amortization/Impairment	(7,614)	(10,727)	(13,061)	(16,619)
Operating Profits	69,314	57,084	87,410	103,546
Interest and investment income	30,495	44,106	75,000	20,000
Interest expenses	(3,566)	(5,190)	(5,500)	(5,700)
Other income	4,160	221	10,000	250
Share of results of equity investees	(20,792)	566	(9,000)	650
Profit before tax	79,611	96,787	157,910	118,746
Tax	(18,199)	(16,553)	(23,686)	(27,312)
Profit after tax	61,412	80,234	134,223	91,435
Minority interests	2,681	7,652	13,422	9,143
Accretion of mezzanine equity	(108)	(286)	(249)	(169)
Profits attributable to ordinary shareholders	63,985	87,600	147,397	100,408
Share-based compensation	20,075	37,491	45,212	57,526
Amortization and impairment	27,583	22,087	13,061	16,619
Gains on disposals/revaluation of investments	(25,945)	(47,525)	(75,000)	(20,000)
Other non-core items	68	1,078	249	169
Non-GAAP profits attributable to ordinary shareholders (Core net profit)	85,766	100,731	130,919	154,722
Growth				
Total revenue (%)	58.1	50.6	33.3	27.2
Gross Profits (%)	45.0	18.6	35.6	25.8
Operating Profits (%)	44.2	(17.6)	53.1	18.5
Net profit (%)	46.5	36.9	68.3	(31.9)
Core net profit (%)	42.2	17.4	30.0	18.2
Operating performance				
Operating margin (%)	27.7	15.1	17.4	16.2
Net margin (%)	25.6	23.2	29.3	15.7
Core net margin (%)	34.3	26.7	26.1	24.2
ROAE (%)	16.9	16.8	21.1	11.6
ROAA (%)	10.5	10.4	13.7	7.8

Note: Individual items may not sum to total due to rounding differences

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY18A-FY21E)

As of Mar 31 (RMB mn)	FY18A	FY19A	FY20E	FY21E
Fixed assets	75,866	92,030	107,030	122,030
Investments	177,892	241,544	252,544	273,194
Other non-current assets	206,511	361,229	368,168	371,549
Total non-current assets	460,269	694,803	727,742	766,773
Cash & equivalents	199,309	189,976	375,834	536,929
Restricted cash and escrow receivables	3,417	8,518	8,518	8,518
Short-term investments and investment securities	10,901	13,189	13,189	13,189
Prepayments, deposits & other assets	43,228	58,590	58,590	58,590
Total current assets	256,855	270,273	456,131	617,226
Total assets	717,124	965,076	1,183,873	1,383,999
Accrued expenses, accounts payable and other liabilities	81,165	117,711	137,632	175,116
Other payables & accruals	16,742	25,935	25,935	25,935
Borrowings and notes	6,028	22,466	22,466	22,466
Deferred revenue	22,297	30,795	50,236	63,917
Merchants deposits	9,578	10,762	10,762	10,762
Total current liabilities	135,810	207,669	247,030	298,196
Borrowings and notes	119,525	111,834	111,834	111,834
Other non-current liabilities	22,350	30,171	30,171	30,171
Total non-current liabilities	141,875	142,005	142,005	142,005
Total liabilities	277,685	349,674	389,035	440,201
Net current assets	121,045	62,604	209,101	319,029
Mezzanine equity	3,001	6,819	7,068	7,237
Equity attributable to shareholders	365,822	492,257	684,866	842,800
Non-controlling interests	70,616	116,326	102,904	93,760
Total equity	436,438	608,583	787,770	936,560

Note: Individual items may not sum to total due to rounding differences

Individual items may varies from reported figures due to rounding differences/definition differences

Source(s): Company, ABCI Securities estimates



Disclosures

Analyst Certification

I, Chow Sau Shing, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report. I and/or my associates have no financial interests (except "Disclosures of Interests" below) in relation to the listed Group (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate $<$ Market return rate (+10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2020 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.

Tel: (852) 2868 2183