

Alibaba (BABA US)

Taking a slower pace

- 3Q18 results showed resilient thanks to new business contribution and taxation benefit despite macro weakness
- Lower FY3/19 revenue guidance due to support measures to SMEs; Taobao's new features could lead to higher monetization potential in the long run
- We believe online shopping is facing less industry headwinds than online gaming within the internet sector. Alibaba remains as our most preferred pick among the major listed internet platforms

3Q18 highlight. In 3Q18, GMV growth of Tmall's physical good has moderated to 30% YoY vs. 34% YoY in 2Q18 amid weaker macro environment. Having said that, revenue growth remained resilient at 54.5% YoY driven by new business initiatives. Non-GAAP operating margin dropped to 24.1% in 3Q18 versus 30.2% in 2Q18 due to ongoing cost pressure from new business initiatives. On a positive note, non-GAAP profit growth accelerated to 12.9% YoY in 3Q18 vs. 2.2% YoY in 2Q18, mainly driven by lower effective tax rate during the quarter.

Short-term relief measures vs. long-term monetization potential. Amid weaker macro environment, the Group lowered its FY3/19 revenue guidance by 4-6% to RMB 375-383bn because of its decision of not monetizing incremental advertising inventory in the near term to support SMEs in its marketplace. Meanwhile, the Group has recently upgraded its mobile Taobao interface which could lead to higher monetization potential in the long run via better user experiences and targeted marketing.

Valuation and recommendation. We lower our FY3/19-20E core profit by 16% and 12% to reflect a weaker near-term growth outlook. After recent share price correction, the counter is currently trading at 21.9x FY3/20 core PE. Our revised TP is US\$ 183, implying 27.6x FY3/20E core P/E. We believe online shopping is facing less industry headwinds than online gaming within the internet sector. Alibaba remains as our most preferred pick among the major listed internet platforms in China.

Risk factors: 1) Chairman succession risk; 2) Regulatory action on cloud computing in overseas market; 3) Tightening regulation on internet finance; 4) Intensified competition; 5) Slowdown in ecommerce; 6) No dividend record to ordinary shareholders.

Financial summary

FY ended Mar 31	FY3/17A	FY3/18A	FY3/19E	FY3/20E
Revenue (RMB mn)	158,273	250,266	376,956	503,910
Chg (% YoY)	56.5	58.1	50.6	33.7
Net profit (RMB mn)	43,675	63,985	67,895	94,799
Chg (% YoY)	(38.9)	46.5	6.1	39.6
Core net profit (RMB mn)	60,309	85,766	93,698	121,373
Chg (% YoY)	40.4	42.2	9.2	29.5
EPS (RMB)	17.5	25.1	26.6	37.1
Chg (% YoY)	(39.7)	43.1	6.1	39.6
Core EPS (RMB)	23.4	32.9	35.9	46.5
Chg (% YoY)	34.1	40.2	9.2	29.5
Core P/E (x)	43.4	30.9	28.3	21.9
P/B (x)	9.1	7.1	5.5	4.3
ROAE (%)	15.3	16.9	13.9	15.7
ROAA (%)	11.6	10.5	8.6	10.0

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Nov 5, 2018

Rating: BUY

TP: US\$ 183

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Share price (US\$)	147.6
Est. share price return	24.0%
Est. dividend yield	0%
Est. total return	24.0%
Previous Rating & TP	BUY/US\$218
Previous Report Date	Aug 9, 2018

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(US\$)	211.7/130.0
Issued shares (mn)	2,561
Market cap (US\$ mn)	382,580
Avg daily turnover (US\$ mn)	3,322
Major shareholder(s)	
Softbank	29.2%
Yahoo	15.0%
Jack Ma	7.0%

Source(s): Company, ABCI Securities

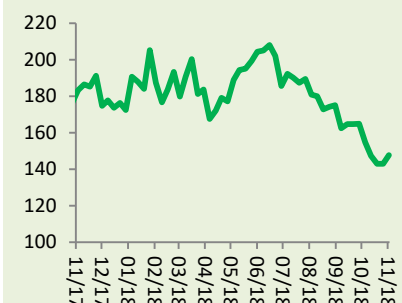
Share Performance (%)

	Absolute	Relative*
1-mth	-4.6	-4.1
3-mth	-18.4	-10.3
6-mth	-21.9	-5.4

*Relative to MXCN

Source(s): Bloomberg, ABCI Securities

Share performance(US\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: 3Q18 highlight

(RMB m)	3Q17	3Q18	YoY%	Remark
Core commerce	46,462	72,475	56%	Driven by new businesses
Cloud computing	2,975	5,667	90%	
Others	5,685	7,006	23%	
Total revenue	55,122	85,148	54%	
Cost of sales	(22,002)	(46,786)	113%	Ongoing investments into new businesses
Gross profit	33,120	38,362	16%	
Product development expenses	(5,083)	(8,365)	65%	
Selling & marketing expenses	(6,266)	(9,106)	45%	
General & admin expenses	(3,439)	(4,779)	39%	
Amortization/Impairment	(1,748)	(2,611)	49%	
Operating Profits	16,584	13,501	-19%	
Interest and investment income	3,435	6,635	93%	
Interest expenses	(747)	(1,340)	79%	
Other income	1,737	(1,532)	-188%	
Share of results of equity investees	(882)	1,254	-242%	
Profit before tax	20,127	18,518	-8%	
Tax	(2,719)	(277)	-90%	Tax benefit
Profit after tax	17,408	18,241	5%	
Minority interests	260	1,892	628%	
Net profit to shareholders	17,668	20,133	14%	
Non-GAAP operating profit	21,270	20,544	-3%	
Non-GAAP net profit to shareholders	22,346	25,233	13%	

Profitability:	3Q17	3Q18	
Gross margin	60.1%	45.1%	Dragged by new retail initiatives
Non-GAAP operating margin	38.6%	24.1%	
Net margin	32.1%	23.6%	
Non-GAAP net margin	40.5%	29.6%	

Source(s): Company, ABCI Securities

We derive Alibaba's fair valuation range based on SOTP approach.

In valuing Alibaba's core business, we apply 20-25x on its FY3/20E core profit. Overall, our target PE implies a PEG of 1.05-1.32x for FY3/20E. We value Ant Financial based on its latest transaction value and investments based on its latest book value.

The SOTP approach results in a fair valuation range of US\$166-US\$200. We set our TP to US\$183, which falls around the mid-point of our fair valuation range. Overall, we assume market participants would remain largely rational to drive Alibaba's share price towards the mid-point of its fair valuation range.

Our TP implies 27.1x FY3/20E core P/E, which is largely in line with Alibaba's historical average P/E.

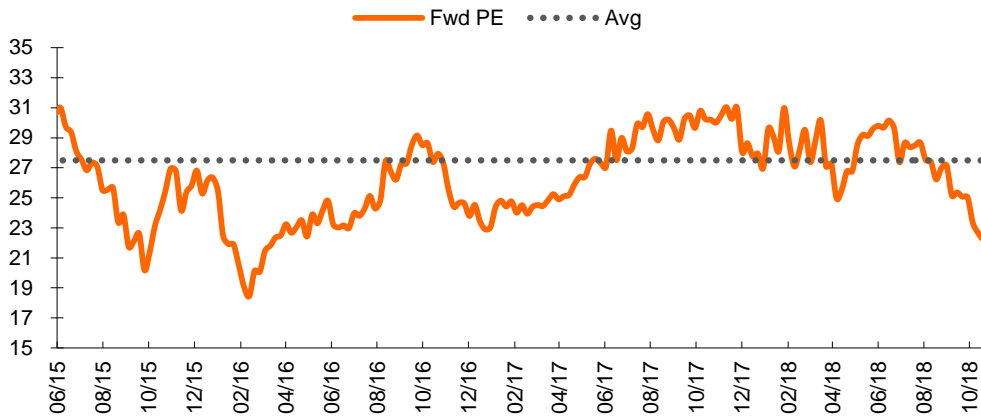
Exhibit 2: SOTP valuation

	Valuation – High end	Valuation – Low end	Valuation – Mid point (USD per share)	Remarks
Core business	169	135	152	20-25x FY20E core profit
Ant Financial	19	19	19	Latest transaction value
Investments	12	12	12	Book value as of Sept 2018
Total	200	166	183	

Source(s): Company, ABCI Securities estimates



Exhibit 3: Alibaba's valuation trend



Source(s): Bloomberg, ABCI Securities



Risk factors

Chairman succession risk

The Group has recently announced that by September 10, 2019, chief executive officer Daniel Zhang will succeed Jack Ma as chairman of the board. Mr. Ma will continue as executive chairman of the company over the next 12 months to ensure a smooth transition of the chairmanship to Mr. Zhang. Mr. Ma will complete his current term as a member of Alibaba Group's board of directors until its annual general meeting of shareholders in 2020.

Regulatory action on cloud computing in overseas market

As the Group operates cloud computing data centers in various overseas markets, including Indonesia, Malaysia, India, Australia, Singapore, Germany, Japan, the US and others, any tightened local regulations in cloud computing in these countries would impact its cloud computing operation. In FY3/18, cloud computing accounted for 5% of total revenue.

Tightening regulation on internet finance

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

Market competition

The Group's peers include other online ecommerce platforms, such as JD.com. The players are competing in the aspects of 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. In our view, competition would be particularly fierce in the online advertising realm which could potentially impact Alibaba's customer management revenue, which accounted for 46% of total revenue in FY3/18.

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. Currently, our economist expects China's GDP to expand by 6.6% YoY in 2018E and 6.4% YoY in 2019E.

No dividend record to ordinary shareholders

The Group has not distributed dividend to ordinary shareholders since listing.

Non-GAAP financial measures

The company has disclosed non-GAAP financial metrics such as non-GAAP operating profit, non-GAAP net profit, etc to supplement its GAAP financial measures. In our view, these non-GAAP financial measures are not standardized and should be used for reference only.



Consolidated income statement (FY17A-FY20E)

FY Ended Mar 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E
Core commerce	133,880	214,020	321,473	423,689
Cloud computing & Internet infrastructure	6,663	13,390	25,441	40,706
Others	17,730	22,856	30,042	39,515
Total revenue	158,273	250,266	376,956	503,910
Cost of sales	(59,483)	(107,044)	(207,434)	(270,568)
Gross profit	98,790	143,222	169,522	233,342
Product development expenses	(17,060)	(22,754)	(38,664)	(46,050)
Selling & marketing expenses	(16,314)	(27,299)	(41,920)	(54,482)
General & admin expenses	(12,239)	(16,241)	(23,893)	(27,997)
Amortization/Impairment	(5,122)	(7,614)	(10,555)	(13,102)
Operating Profits	48,055	69,314	54,490	91,712
Interest and investment income	8,559	30,495	26,500	27,000
Interest expenses	(2,671)	(3,566)	(4,500)	(4,700)
Other income	6,086	4,160	(2,500)	(2,500)
Share of results of equity investees	(5,027)	(20,792)	500	600
Profit before tax	55,002	79,611	74,490	112,112
Tax	(13,776)	(18,199)	(12,663)	(25,786)
Profit after tax	41,226	61,412	61,827	86,326
Minority interests	2,449	2,681	6,183	8,633
Accretion of mezzanine equity		(108)	(115)	(160)
Profits attributable to ordinary shareholders	43,675	63,985	67,895	94,799
Share-based compensation	15,995	20,075	41,633	40,313
Amortization and impairment	7,664	27,583	10,555	13,102
Gains on disposals/revaluation of investments	(7,346)	(25,945)	(26,500)	(27,000)
Other non-core items	321	68	115	160
Non-GAAP profits attributable to ordinary shareholders (Core net profit)	60,309	85,766	93,698	121,373
EPS (RMB)	17.5	25.1	26.6	37.1
Growth				
Total revenue (%)	56.5	58.1	50.6	33.7
Gross Profits (%)	47.9	45.0	18.4	37.6
Operating Profits (%)	65.1	44.2	(21.4)	68.3
Net profit (%)	(38.9)	46.5	6.1	39.6
Core net profit (%)	40.4	42.2	9.2	29.5
Operating performance				
Operating margin (%)	30.4	27.7	14.5	18.2
Net margin (%)	27.6	25.6	18.0	18.8
Core net margin (%)	38.1	34.3	24.9	24.1
ROAE (%)	15.3	16.9	13.9	15.7
ROAA (%)	11.6	10.5	8.6	10.0

Source(s): Company, ABCI Securities estimates

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

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



Consolidated balance sheet (FY17A-FY20E)

As of Mar 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E
Fixed assets	24,897	75,866	75,866	75,866
Intangible assets	151,820	177,892	228,392	278,992
Investment in equity investees	147,579	206,511	205,956	202,855
Investment securities	324,296	460,269	510,214	557,713
Goodwill	143,736	199,309	290,333	416,951
Prepayments, deposits & other assets	2,655	3,417	3,417	3,417
Total non-current assets	7,065	10,901	10,901	10,901
Cash & equivalents	29,060	43,228	43,228	43,228
Restricted cash and escrow receivables	182,516	256,855	347,879	474,497
Short-term investments and investment securities	506,812	717,124	858,093	1,032,210
Prepayments, deposits & other assets	47,186	81,165	103,275	138,058
Total current assets	8,447	16,742	16,742	16,742
Total assets	14,897	6,028	6,028	6,028
Accrued expenses, accounts payable and other liabilities	15,052	22,297	37,696	50,391
Other payables & accruals	8,189	9,578	9,578	9,578
Borrowings and notes	93,771	135,810	173,319	220,797
Deferred revenue	76,835	119,525	119,525	119,525
Merchants deposits	12,085	22,350	22,350	22,350
Total current liabilities	88,920	141,875	141,875	141,875
Borrowings and notes	182,691	277,685	315,194	362,672
Deferred revenue	88,745	121,045	174,560	253,700
Other non-current liabilities	2,992	3,001	3,116	3,276
Total non-current liabilities	278,799	365,822	475,350	610,462
Total liabilities	42,330	70,616	64,433	55,801
Net current assets	321,129	436,438	539,784	666,262
Mezzanine equity	24,897	75,866	75,866	75,866
Equity attributable to shareholders	151,820	177,892	228,392	278,992
Non-controlling interests	147,579	206,511	205,956	202,855
Total equity	324,296	460,269	510,214	557,713

Source(s): Company, ABCI Securities estimates

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

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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 2005 (HSI total return index 2005-17 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.

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