

Alibaba (BABA US)

Value unlocked in core commerce

- Business momentum remains intact in 4Q17 with revenue and non-GAAP net profit growing 56% and 20% YoY
- Transformation from distribution platform to online marketer has led to robust growth in core commerce
- AliCloud may follow Amazon Web Services's successful path by leveraging on its strong in-house capabilities
- Acquisition of 33% stakes in Ant Financial paves the way for IPO in coming years
- We see relative value versus Tencent. Maintain **BUY** with a TP of US\$ 232

Momentum remains intact in 4Q17. In 4Q17 (3QFY3/18), revenue and non-GAAP net profit grew 56% to 20% YoY to RMB 83bn (4% above consensus) and RMB 27.7bn (in line with consensus).

Core commerce – from distribution platform to online marketer. Core commerce segment continued to deliver a much higher revenue growth of 57% in 4Q17 than China's overall E-commerce growth (+32% in 2017), thanks to rising online marketing service revenue via effective use of A.I. and big data technology. By unlocking value from its ecosystem, Alibaba, by our estimate, has the no. 1 market share (c. 28%) in China's online advertising market.

Cloud computing- China's AWS. Cloud revenue growth stayed strong at 104% in 4Q17. Alibaba may potentially follow a similar path as Amazon Web Services (AWS) by leveraging on its strong in-house cloud capabilities in core e-commerce business extending to external customers.

Acquiring 33% stakes in Ant Financial. Alibaba agrees to purchase a 33% stake in Ant Financial by intellectual property rights and will terminate the current 37.5% pretax profit-sharing arrangement. In 2017, pretax profit sharing from Ant Financial, in the form of royalty and software technology service fees, amounted to RMB4.9bn, implying RMB13.2bn of pretax profit for Ant Financial in 2017.

Relative value vs. Tencent (700 HK). Currently, Tencent is trading at a ~35% valuation premium over Alibaba in terms of P/E, higher than the historical average of ~20%. In our view, Alibaba enjoys a better relative value compared to Tencent. We maintain **BUY** with a SOTP-based TP of US\$ 232.

Risk factors: 1) Tightening regulation on internet finance; 2) Intensified competition; 3) Slowdown in e-commerce; 4) No dividend record to ordinary shareholders

Results and Valuation

FY ended Mar 31	FY3/16A	FY3/17A	FY3/18E	FY3/19E
Revenue (RMB mn)	101,143	158,273	247,090	345,289
Chg (% YoY)	32.7	56.5	56.1	39.7
Net profit (RMB mn)	71,460	43,675	65,197	87,762
Chg (% YoY)	194.5	(38.9)	49.3	34.6
Non-GAAP net profit (RMB mn)	42,962	60,309	84,964	115,385
Chg (% YoY)	76.7	40.4	40.9	35.8
EPS (RMB)	29.1	17.5	26.2	35.2
Chg (% YoY)	181.3	(39.7)	49.3	34.6
BVPS (RMB)	88.3	111.8	138.0	173.2
Core P/E (x)	70.4	50.3	35.7	26.3
P/B (x)	13.4	10.6	8.6	6.8
ROAE (%)	35.0	15.2	18.3	20.4
ROAA (%)	23.1	10.0	11.4	12.2

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Feb 5, 2018
 Rating: **BUY**
 TP: US\$ 232

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Share price (US\$)	187.3
Est. share price return	23.9%
Est. dividend yield	0%
Est. total return	23.9%
Previous Rating & TP	BUY/US\$222
Previous Report Date	Dec 6, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(US\$)	205.7/100.0
Issued shares (mn)	2,561
Market cap (US\$ mn)	492,224
Avg daily turnover (US\$ mn)	3,659
Major shareholder(s)	
Softbank	29.2%
Yahoo	15.0%
Jack Ma	7.0%

Source(s): Company, ABCI Securities

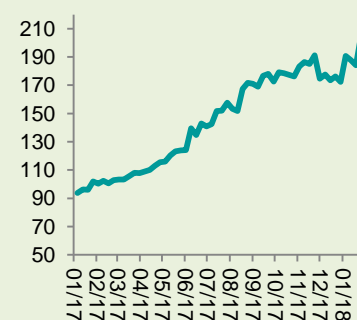
Share Performance (%)

	Absolute	Relative*
1-mth	15.8	4.2
3-mth	8.0	-7.7
6-mth	28.9	2.9

*Relative to MXCN

Source(s): Bloomberg, ABCI Securities

Share performance(US\$)



Source(s): Bloomberg, ABCI Securities



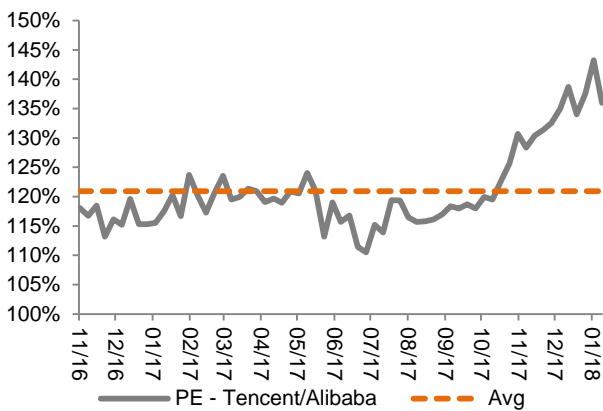
Exhibit 1: SOTP valuation

	Valuation (USD per share)	Remarks
Core business	213.5	30x FY19E core profit
Ant Financial	8.7	43x 2017E profit*
Investments	9.8	Book value
Total	232	

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

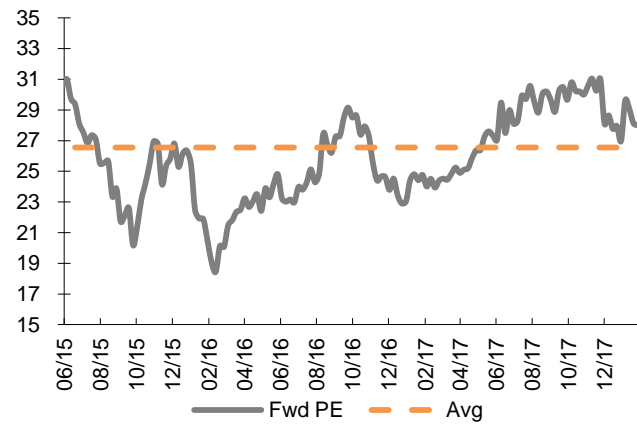
*Assuming 25% tax rate on RMB13.2bn estimated pretax profit in 2017 based on Alibaba's disclosed profit sharing amount (in the form of royalty and software technology service fees) from Ant Financial. The 43x PE multiple is benchmarked to PayPal's 2017 PE.

Exhibit 2: P/E – Tencent/Alibaba



Source(s): Bloomberg, ABCI Securities

Exhibit 3: Alibaba – Forward P/E



Source(s): Bloomberg, ABCI Securities



Exhibit 4: 4Q17 highlight

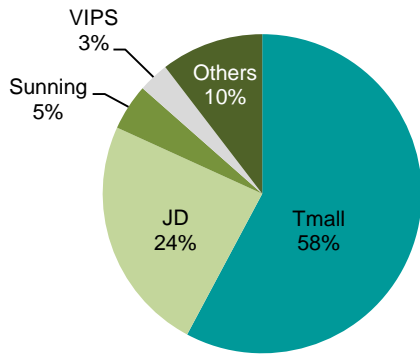
Results review: (RMB m)	4Q16	4Q17	% y-o-y	Remarks
Core commerce	46,576	73,244	57%	Driven by online marketing service
Cloud computing	1,764	3,599	104%	
Others	4,908	6,185	26%	
Total revenue	53,248	83,028	56%	
Cost of sales	19,126	35,078	83%	
Gross profit	34,122	47,950	41%	
Product development expenses	4,420	6,289	42%	
Selling & marketing expenses	4,490	8,542	90%	
General & admin expenses	3,287	4,572	39%	
Amortization/Impairment	1,261	2,057	63%	
Operating Profits	20,664	26,490	28%	
Interest and investment income	837	23,643	2725%	Revaluation gain of Cainiao Network
Interest expenses	701	844	20%	
Other income	3,015	(348)	-112%	Lower profit sharing from Ant Financial
Share of results of equity investees	(1,548)	(18,452)	1092%	Impairment of Alibaba Pictures
Profit before tax	22,267	30,489	37%	
Tax	5,110	6,663	30%	
Profit after tax	17,157	23,826	39%	
Minority interests	698	741	6%	
Net profit to shareholders	17,855	24,073	35%	
Non-GAAP net profit to shareholders	23,186	27,744	20%	

Profitability:	4Q16	4Q17	
Gross margin	64.1%	57.8%	Dragged by new retail initiatives
Operating margin	38.8%	31.9%	
Net margin	33.5%	29.0%	
Core net margin (non-GAAP)	43.5%	33.4%	

Source(s): Company, ABCI Securities

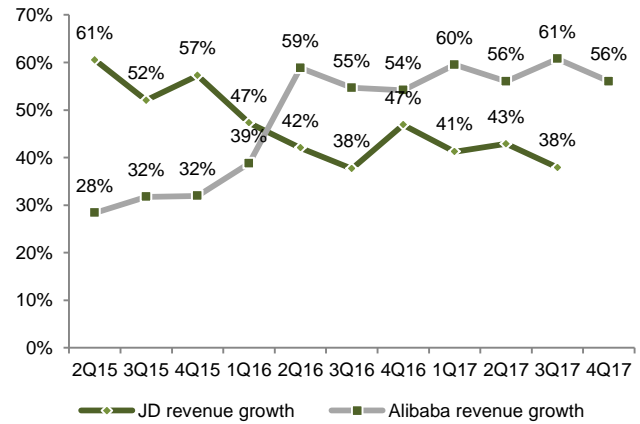


Exhibit 5: B2C e-commerce market share -3Q17



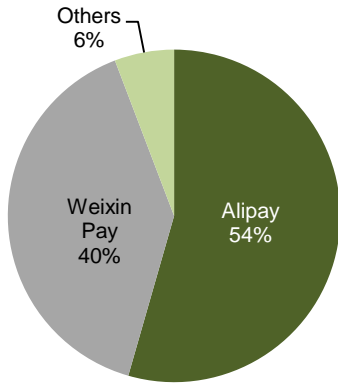
Source(s): iResearch, ABCI Securities

Exhibit 6: Revenue growth – Alibaba vs. JD.com



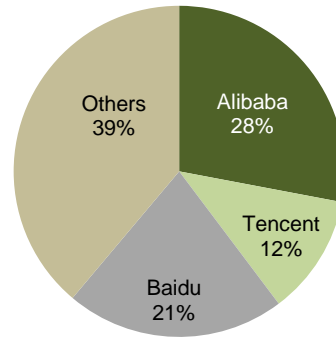
Source(s): Companies, ABCI Securities

Exhibit 7: Third- party mobile payment market share -2Q17



Source(s): iResearch, ABCI Securities

Exhibit 8: Online advertising market share -3Q17



Source(s): iResearch, companies, ABCI Securities



Consolidated income statement (FY16A-FY19E)

FY Ended Mar 31 (RMB mn)	FY16A	FY17A	FY18E	FY19E
Core commerce	92,335	133,880	211,601	295,156
Cloud computing & Internet infrastructure	3,019	6,663	13,326	21,322
Others	5,789	17,730	22,163	28,811
Total revenue	101,143	158,273	247,090	345,289
Cost of sales	34,355	59,483	98,836	143,295
Gross profit	66,788	98,790	148,254	201,994
Product development expenses	13,788	17,060	23,474	32,802
Selling & marketing expenses	11,307	16,314	24,709	34,529
General & admin expenses	9,205	12,239	17,296	24,170
Amortization/Impairment	3,386	5,122	8,648	12,085
Operating Profits	29,102	48,055	74,127	98,407
Interest and investment income	52,254	8,559	29,000	9,000
Interest expenses	1,946	2,671	3,400	3,400
Other income	2,058	6,086	3,500	2,000
Share of results of equity investees	-1,730	-5,027	-21,022	500
Profit before tax	79,738	55,002	82,205	106,507
Tax	8,449	13,776	18,907	21,301
Profit after tax	71,289	41,226	63,298	85,206
Minority interests	171	2,449	1,899	2,556
Profits attributable to shareholders	71,460	43,675	65,197	87,762
Non-GAAP profits attributable to shareholders	42,962	60,309	84,964	115,385
Growth				
Total revenue (%)	32.7	56.5	56.1	39.7
Gross Profits (%)	27.5	47.9	50.1	36.2
Operating Profits (%)	25.8	65.1	54.3	32.8
Net profit (%)	194.5	(38.9)	49.3	34.6
Non-GAAP net profit (%)	76.7	40.4	40.9	35.8
Operating performance				
Operating margin (%)	28.8	30.4	30.0	28.5
Net margin (%)	70.7	27.6	26.4	25.4
Core net margin (%)	42.5	38.1	34.4	33.4
ROAE (%)	35.0	15.2	18.3	20.4
ROAA (%)	23.1	10.0	11.4	12.2

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY16A-FY19E)

As of Mar 31 (RMB mn)	FY16A	FY17A	FY18E	FY19E
Fixed assets	16,505	24,897	24,897	24,897
Intangible assets	5,370	14,108	15,460	13,375
Investment in equity investees	91,461	120,368	149,346	199,846
Investment securities	29,392	31,452	31,452	31,452
Goodwill	81,645	125,420	175,420	225,420
Prepayments, deposits & other assets	5,837	8,051	8,051	8,051
Total non-current assets	230,210	324,296	404,626	503,041
Cash & equivalents	106,818	143,736	196,871	260,386
Restricted cash	1,346	2,655	2,655	2,655
Short-term investments	8,878	7,065	7,065	7,065
Other receivables and prepayments	-	-	-	-
Other current assets	16,993	29,060	29,060	29,060
Total current assets	134,035	182,516	235,651	299,166
Total assets	364,245	506,812	640,277	802,206
Accounts payable	27,334	47,186	67,696	94,600
Other payables & accruals	2,790	8,447	8,447	8,447
Borrowings and notes	4,304	14,897	14,897	14,897
Deferred revenue	10,297	15,052	24,709	34,529
Merchants deposits	7,314	8,189	8,189	8,189
Total current liabilities	52,039	93,771	123,938	160,662
Borrowings and notes	53,262	76,835	116,835	156,835
Deferred revenue	418	641	641	641
Other non-current liabilities	8,637	11,444	11,444	11,444
Total non-current liabilities	62,317	88,920	128,920	168,920
Total liabilities	114,356	182,691	252,858	329,582
Net current assets	81,996	88,745	111,713	138,504
Mezzanine equity	350	2,992	2,992	2,992
Equity attributable to shareholders	216,987	278,799	343,996	431,758
Non-controlling interests	32,552	42,330	40,431	37,875
Total equity	249,889	324,121	387,419	472,625

Source(s): Company, ABCI Securities estimates

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Analyst Certification

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ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

Steve Chow holds H-shares of Tencent (700 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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