

Alibaba (9988 HK/BABA US)

Ongoing operational improvement

- Discretionary-led recovery a positive sign for ecommerce sector
- High R&D spending lay solid foundation for AI development crucial in long-term competitiveness
- Maintain **BUY** on receding regulatory risk and ongoing operational improvement

Ongoing operational improvement. In 4Q22 (3QFY3/23), Alibaba's revenue increased 2.1% YoY to RMB 248bn. Core net profit increased 10% YoY to RMB 50.3bn driven by ongoing operational improvement. Core net margin was 20.3% in 4Q22 vs. 16.6% in 3Q22. Operating margin of loss-making segment, such as local consumer services, innovation initiatives, etc. improved from -16.7% in 3Q22 to -15.3% in 4Q22, while operating margin of China commerce edged up from 30.5% in 3Q22 to 31.3% in 4Q22.

Recovery underway. Ecommerce sales started to recover in Feb 2023 due to easing COVID situation, with apparel, sports, and outdoor categories outperforming the others. We believe it is a positive signal for the ecommerce sector since recovery has been led by consumer discretionary, which might indicates resumption of consumer confidence.

Solid foundation for AI initiatives. Thanks to large operational scale and strong financial resources, Alibaba's R&D spending has been among the highest among peers. The Company has been applying various AI technologies such as personalized search results and intelligent customer service to enhance user experiences and stickiness. These efforts and initiatives have laid a strong foundation for Alibaba in the long-term AI race crucial to platform efficiencies.

Valuation play. Maintain **BUY** with SOTP-based TP at HK\$ 130 for Alibaba-SW (9988 HK) and US\$ 132 for Alibaba-ADR (BABA US). The Company's current low valuation at about 10.4x FY24E core P/E presents an entry point for long-term investors, where improving operating environment and receding regulatory risk could lead to re-rating in coming months, in our view.

Results and Valuation

FY end Mar 31	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	853,062	873,349	967,844	1,066,826
Chg (% YoY)	18.9	2.4	10.8	10.2
Net profit (RMB mn)	61,959	70,702	117,656	136,062
Chg (% YoY)	(58.8)	14.1	66.4	15.6
Core net profit (RMB mn)	143,515	138,376	160,940	182,665
Chg (% YoY)	(19.8)	(3.6)	16.3	13.5
Underlying EPS (RMB)	2.9	3.4	5.7	6.5
Chg (% YoY)	(58.7)	18.2	66.4	15.6
Core EPS (RMB)*	6.6	6.6	7.7	8.7
Chg (% YoY)	(19.1)	0.5	16.3	13.5
Core P/E (x)- ADR*	11.5	11.5	9.9	8.7
Core P/E (x)-SW share*	12.2	12.1	10.4	9.2
ROAE (%)	5.8	6.3	9.6	9.9
ROAA (%)	3.7	4.0	6.2	6.5

1 ADR = 8 ordinary shares

*Excluding share-based compensation, impairments, fair value changes of investment, etc.

Source (s): Bloomberg, ABCI Securities estimates

Company Report

Mar 1, 2023

Rating: BUY

Rating (SW-share): BUY

TP (SW-share): HK\$ 130

Rating (ADR): BUY

TP (ADR): US\$ 132

Analyst : Steve Chow

Tel: (852) 2147 8809

stevechow@abci.com.hk

Price (ADR/SW-share)	US\$87.8/ HK\$91.9
Est. share price return (ADR/SW-share)	50.9%/41.5%
Est. dividend yield (ADR/SW-share)	NA/NA
Est. total return (ADR/SW-share)	50.9%/41.5%
Last Rating & TP (ADR/SW-share)	US\$123/ HK\$120

Previous Report Date Dec 29, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (SW-share)	122.0/60.2
52Wk H/L (US\$) (ADR)	125.8/58.0
Issued shares (mn)	20,700
Market cap (HK\$ mn) (all share)	1,889,910
3-mth avg daily turnover (HK\$ mn) (SW-share)	5,342
3-mth avg daily turnover (US\$ mn) (ADR)	2,604
Major shareholder(s) (%): SoftBank	14.6%

Source(s): Bloomberg, HKEx, Company

Recent business update

In 4Q22 (3QFY3/23), Alibaba's revenue increased 2.1% YoY to RMB 248bn. Core net profit rose 10% YoY to RMB 50.3bn on better cost control. 4Q22 also marks the second consecutive quarter of positive core net profit growth since 3Q22 after four quarters of core profit declines between 3Q21 and 2Q22, indicating ongoing operational improvement.

China commerce revenue, which includes e-commerce and retail businesses such as Taobao, Tmall, Taobao Deals, Taocaicai, Freshippo, Sun Art, etc., was down 1.1% YoY in 4Q22 vs. 0.5% YoY decline in 3Q22 due to rising COVID cases in 4Q22. GMV of Taobao and Tmall dropped by mid-single-digit compared to the low-single-digit decline in 3Q22 mainly due to weakness in fashion and accessories, though growth was seen in healthcare, pet care, and fresh products. Losses in Taobao Deals and Taocaicai continued to narrow thanks to product improvement. On the other hand, cloud revenue grew 3% YoY in 4Q22 mainly driven by 9% revenue growth from non-internet industries such as financial services, education, and automobile.

Core net margin was 20.3% in 4Q22 vs. 16.6% in 3Q22 thanks to cost optimization. Operating margin of China commerce edged up from 30.5% in 3Q22 to 31.3% in 4Q22, while operating margin of non-China commerce businesses such as international commerce, Cainiao, cloud, local consumer services, innovation initiatives, etc. improved from -16.7% in 3Q22 to -15.3% in 4Q22.

According to the management, online sales have recovered since Feb 2023 due to easing COVID situation, with apparel, sports, and outdoor categories outperforming the others. We view this consumer discretionary-led recovery as an encouraging signal in resumption of consumer confidence.

R&D spending supporting AI development

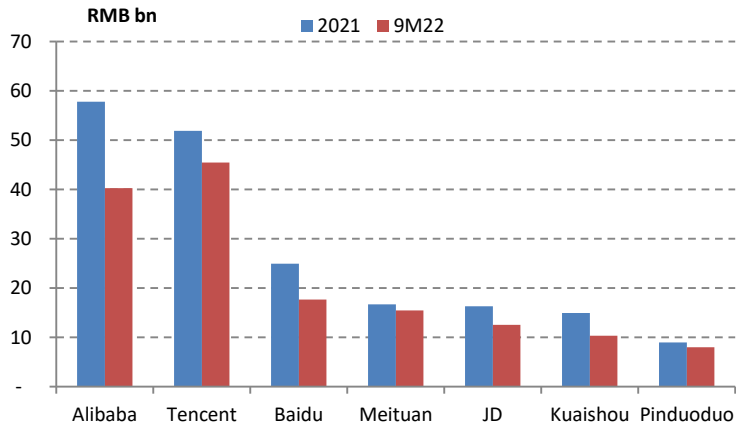
The Company would continue to focus on AI applications to enhance user experiences and operational efficiency. In our view, R&D resources and capabilities would be the key in determining long-term competitiveness of AI products on any platforms.

Alibaba has been applying AI technologies across its ecosystem, such as personalized search results and shopping experiences, interactive content formats enabled by deep learning and data analytics in search functions, and intelligent customer service leveraging speech recognition, image, and video analysis technologies.

Among the major online platforms in China, Alibaba and Tencent (700 HK) have been the leaders in R&D spending. Their larger operational scale and stronger financial position have enabled them to continue investing in new technologies, including AI, to increase long-term competitiveness.



Exhibit 1: R&D expense



Source(s): Companies, ABCI Securities

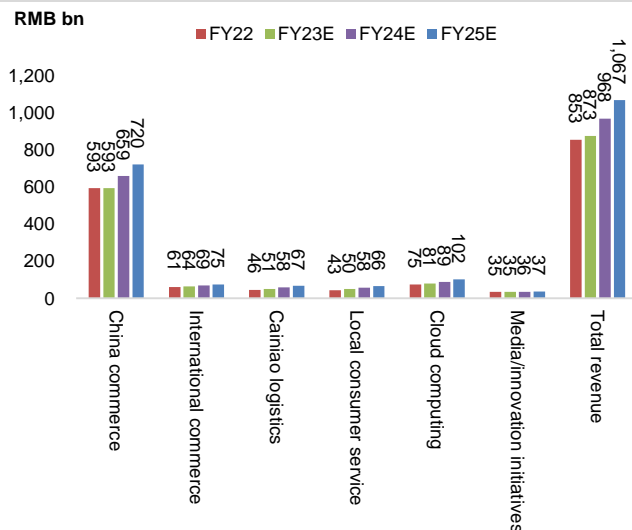
Financial Outlook

We expect revenue to grow at 11% CAGR in FY3/23-25E.

China commerce revenue is expected to expand at 10% CAGR in FY3/23-25E. Overall, China commerce is the major growth driver accounting for about 69% of the Company's total revenue in FY3/22, and we expect the trend to continue in the near future.

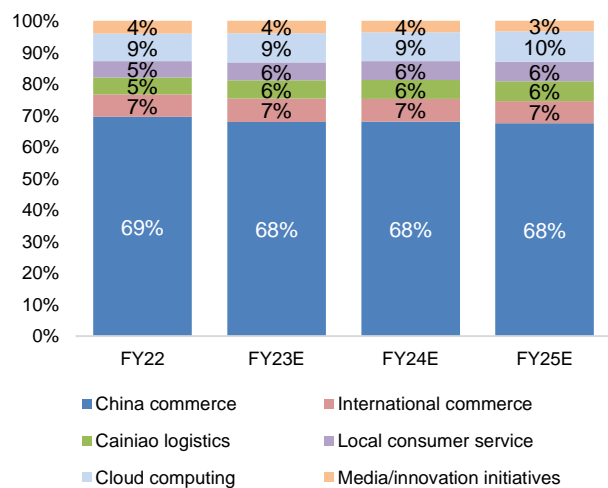
For other businesses, we expect international commerce to grow at 8% CAGR in FY3/23-25E, with Cainiao and local consumer service expanding at 15% CAGR each in FY3/23-25E. In addition, cloud and DME (digital media and entertainment)/innovation initiatives and others would grow at 12% and 3% CAGRs in FY3/23-25E. These businesses collectively accounted for about 30% of total revenue currently, and we expect its contribution to remain largely stable going forward.

Exhibit 2: Revenue outlook



Source(s): Company, ABCI Securities estimates

Exhibit 3: Revenue mix outlook



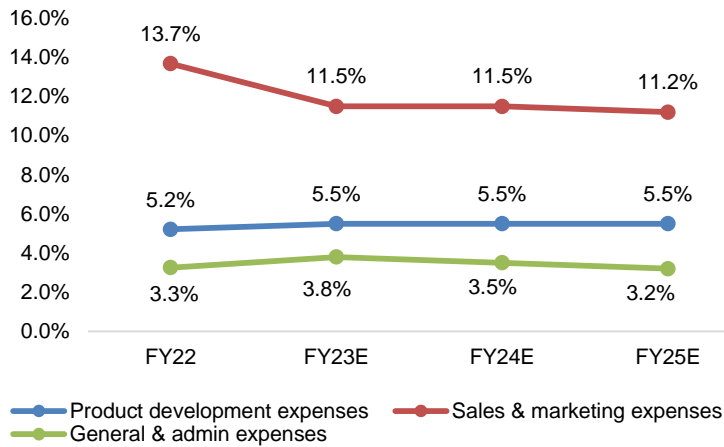
Source(s): Company, ABCI Securities estimates

Gross margin: We expect gross margin to rebound to 37.0% in FY3/25E vs. 36.8% in FY3/22 on better cost control.

Product development expense: We expect non-GAAP product development expenses/sales ratio to be 5.5% in FY3/25E vs. 5.2% in FY3/22, indicating ongoing R&D investments in new services for merchants and consumers to increase loyalty.

Sales and marketing expenses: We expect non-GAAP sales and marketing expenses/sales ratio to drop from 13.7% in FY3/22 to 11.2% in FY3/25E due to cost control and improving economies of scale for new businesses such as Taobao Deals, Taocaicai, etc.

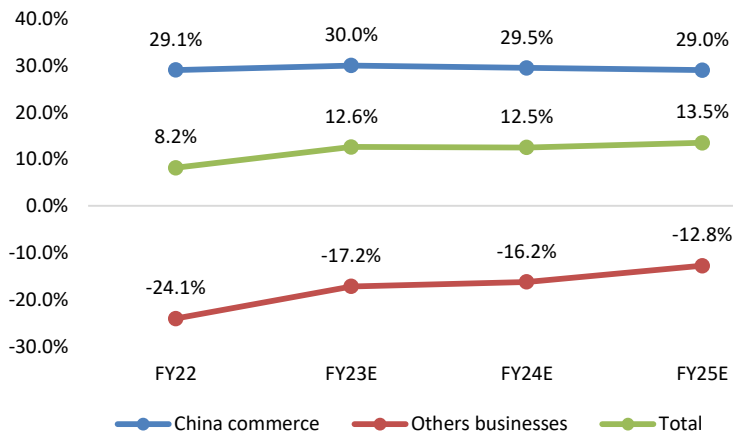
General & admin expenses: We expect non-GAAP general & admin expenses /sales ratio to be 3.2% in FY3/25E vs. 3.3% in FY3/22.

Exhibit 4: Non-GAAP* cost trend (% of revenue)


* Excluding impacts of share-based compensation and other non-operating items

Source(s): Company, ABCI Securities estimates

The Company has made headways in cost optimization, which is one of its major priorities. We expect operating margin of non-China commerce businesses (international commerce, local consumer service, Cainiao, cloud, media, and innovation initiatives) to improve from -24.1% in FY3/22 to -12.8% in FY3/25E driven by cost control; on the other hand, the operating margin of China commerce business would drop from 29.1% in FY3/22 to 29.0% in FY3/25E.

Exhibit 5: Segment operating margin outlook


Source(s): Company, ABCI Securities estimates

We expect core net margin (excl. impacts of share-based compensation and other non-operating items) to rise to 17.1% in FY3/25E vs. 16.8% in FY3/22. This implies a 15% core net profit CAGR in FY3/23-25E.



Exhibit 6: Forecast changes for FY3/23E

(RMB mn)	Old	New	Diff.	Comment
Revenue	899,938	873,349	-3%	
Core profit	127,321	138,376	9%	Cost optimization

Source(s): ABCI Securities estimates

Exhibit 7: Forecast changes for FY3/24E

(RMB mn)	Old	New	Diff.	Comment
Revenue	1,013,059	967,844	-4%	Lower growth assumptions
Core profit	160,023	160,940	1%	

Source(s): ABCI Securities estimates

Valuation and TP

Maintain **BUY** with SOTP-based TP at HK\$ 130 for Alibaba-SW (9988 HK) and US\$ 132 for Alibaba-ADR (BABA US), given Alibaba's leading market position in the ecommerce sector.

Alibaba-SW (9988 HK): We set our SOTP-based TP at HK\$ 130.

Alibaba-ADR (BABA US): Based on our TP of Alibaba-SW, we set the corresponding TP of Alibaba-ADR at US\$ 132 (1 ADR represents 8 shares).

Exhibit 8: SOTP sensitivity for Alibaba-SW (9988 HK)

(HKD per share)	Low	High	Remarks
Core business#	85	120	DCF - from 16% to 10% WACC
Strategic investments	24	24	Book value
Total	105	145	

excluding contribution of equity investees

Source(s): ABCI Securities estimates

We believe its current valuation at about 10.4x FY24E core P/E presents an entry point for long-term investors. Its current valuation is approaching the low end of historical range. In our view, an improving operating environment and receding regulatory risk could lead to re-rating in coming months. Compared with major online platforms such as Tencent, Alibaba's current valuation also represents good relative value.

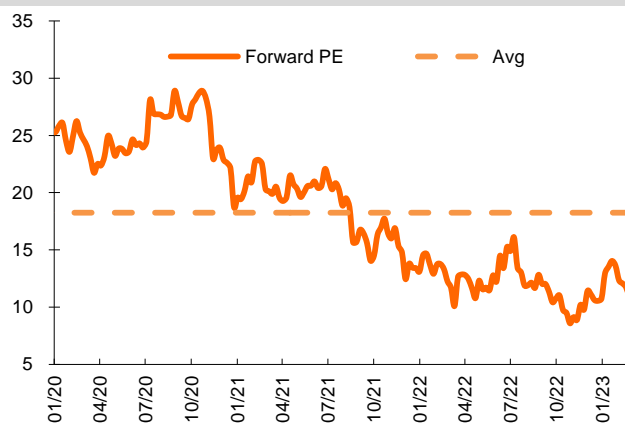
The Company has increased its share repurchase effort to mitigate ongoing disposal risk by SoftBank. At end-2022, the Company had USD 21.3bn remaining under the current share repurchase program till Mar 2025.

Exhibit 9: TP changes (HK\$/shr)

Old	New	Remark
120	130	SOTP-based; Implying 14.9x FY24E core P/E versus 13.7x previously

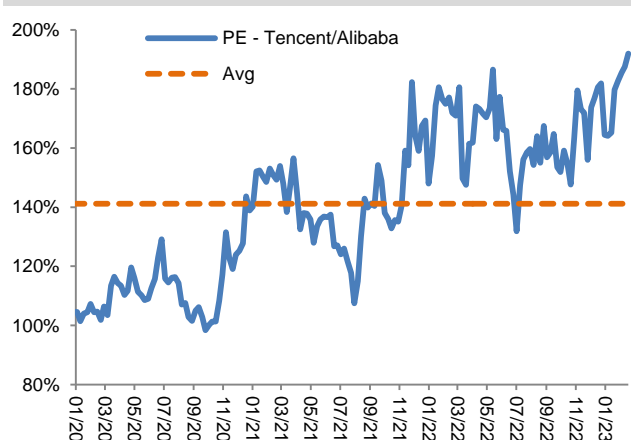
Source(s): ABCI Securities estimates

Exhibit 10: Alibaba's fwd. core P/E



Source(s): Bloomberg, ABCI Securities

Exhibit 11: Relative value versus Tencent



Source(s): Bloomberg, ABCI Securities



Financial Forecast

Consolidated income statement (FY22A-FY25E)

FY Ended Mar 31 (RMB mn)	FY22A	FY23E	FY24E	FY25E
Total revenue	853,062	873,349	967,844	1,066,826
Cost of sales	(539,450)	(549,937)	(612,573)	(672,021)
Gross profit	313,612	323,412	355,270	394,804
Product development expenses	(55,465)	(59,291)	(66,152)	(72,918)
Selling & marketing expenses	(119,799)	(103,547)	(114,873)	(123,421)
General & admin expenses	(31,922)	(37,432)	(38,747)	(39,509)
Amortization/Impairment	(36,788)	(13,100)	(14,518)	(14,936)
Operating Profits	69,638	110,042	120,980	144,021
Interest and investment income	(15,702)	(20,000)	9,500	9,500
Interest expenses	(4,909)	(5,500)	(5,800)	(5,800)
Other income	10,523	4,500	5,500	5,500
Share of results of equity investees	14,344	(10,000)	7,500	7,500
Profit before tax	73,894	79,042	137,680	160,721
Tax	(26,815)	(15,808)	(27,536)	(32,144)
Profit after tax	47,079	63,234	110,144	128,577
Minority interests	15,170	7,588	7,710	7,715
Accretion of mezzanine equity	(290)	(119)	(199)	(230)
Profits attributable to ordinary shareholders	61,959	70,702	117,656	136,062
Share-based compensation	23,971	24,454	28,067	30,938
Amortization and impairment	51,911	23,100	24,518	24,936
Gains on disposals/revaluation of investments	21,671	20,000	(9,500)	(9,500)
Other non-core items	(15,997)	119	199	230
Non-GAAP profits attributable to ordinary shareholders (Core net profit)	143,515	138,376	160,940	182,665
Growth				
Total revenue (%)	18.9	2.4	10.8	10.2
Gross Profits (%)	5.9	3.1	9.9	11.1
Operating Profits (%)	(22.3)	58.0	9.9	19.0
Net profit (%)	(58.8)	14.1	66.4	15.6
Core net profit (%)	(19.8)	(3.6)	16.3	13.5
Operating performance				
Operating margin (%)	8.2	12.6	12.5	13.5
Net margin (%)	7.3	8.1	12.2	12.8
Core net margin (%)	16.8	15.8	16.6	17.1

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

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY22A-FY25E)

As of Mar 31 (RMB mn)	FY22A	FY23E	FY24E	FY25E
Fixed assets	171,806	184,306	206,306	222,806
Investments	443,253	488,253	548,753	609,253
Other non-current assets	441,959	477,859	515,341	552,406
Total non-current assets	1,057,018	1,150,418	1,270,400	1,384,465
Cash & equivalents	189,898	105,142	111,303	168,520
Restricted cash and escrow receivables	37,455	41,201	43,261	45,424
Short-term investments and investment securities	265,187	325,187	345,187	365,187
Prepayments, deposits & other assets	145,995	189,794	208,773	229,650
Total current assets	638,535	661,323	708,524	808,781
Total assets	1,695,553	1,811,740	1,978,924	2,193,245
Accrued expenses, accounts payable and other liabilities	271,460	275,165	278,421	306,895
Other payables & accruals	21,753	22,841	23,983	25,182
Borrowings and notes	8,841	13,841	21,841	29,841
Deferred revenue	66,983	69,868	77,427	85,346
Merchants deposits	14,747	15,484	16,259	17,071
Total current liabilities	383,784	397,199	417,931	464,335
Borrowings and notes	132,503	144,503	149,503	154,503
Other non-current liabilities	97,073	100,158	103,398	106,799
Total non-current liabilities	229,576	244,661	252,901	261,302
Total liabilities	613,360	641,860	670,831	725,638
Net current assets	254,751	264,124	290,593	344,445
Mezzanine equity	9,655	9,774	9,973	10,203
Equity attributable to shareholders	948,479	1,043,635	1,189,358	1,356,359
Non-controlling interests	124,059	116,471	108,761	101,046
Total equity	1,072,538	1,160,106	1,298,119	1,457,405

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

Consolidated cash flows statement (FY22A-FY25E)

As of Mar 31 (RMB mn)	FY22A	FY23E	FY24E	FY25E
Net income	47,079	63,234	110,144	128,577
Depreciation and amortization	48,065	40,600	42,518	43,436
Other non-cash adjustments	65,765	34,454	20,567	23,438
Change in working capital	(18,150)	(36,044)	(5,068)	18,766
Operating cash flow	142,759	102,244	168,161	214,217
Investing cash flow	(198,592)	(204,000)	(175,000)	(170,000)
Financing cash flow	(64,449)	17,000	13,000	13,000
Net cash flows	(120,282)	(84,756)	6,161	57,217

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

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Source(s): Company, ABCI Securities estimates



Risk factors

Market competition

The ecommerce industry is highly competitive, with companies contending on commission rate, promotion discount, brand advertising, technological investment, and more.

Slowdown in ecommerce consumption

As the industry is dependent on consumer spending, any significant slowdown of consumption in China would hamper the Group's performance. In the long term, we believe consumption growth in domestic market would converge with income growth, which is usually in line with GDP growth.

Loss making segments

Except China commerce segment, other segments (international commerce, local consumer services, Cainiao, cloud, digital media and entertainment, and innovation initiatives and others) recorded loss from operations. If their losses enlarge, overall business performance will be adversely affected.

Non-GAAP financials

Ecommerce platforms generally disclosed the non-GAAP financial metrics, such as the non-GAAP net profit, to supplement its GAAP financial measures. Historically, there were differences between its GAAP net profit and non-GAAP net profit due to inclusion of items such as share-based compensation and other non-core items in the former.

Among these items, share-based compensation expense is related to various factors including price movement of ordinary shares, expected volatility, risk-free interest rate, etc.

While investors tend to exclude these items when performing analysis given their non-cash nature, we believe these non-GAAP financial measures should only serve as references.



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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 9\%$)
Hold	- Market return rate ($\sim 9\%$) \leq Stock return rate $<$ Market return rate ($\sim 9\%$)
Sell	Stock return $<$ - Market return ($\sim 9\%$)

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 2006 (HSI total return index 2006-22 CAGR at 8.4%)

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

Tel: (852) 2868 2183