



## Alibaba (9988 HK/BABA US)

### Valuation play

- Restructuring of business units to enhance shareholders' return
- Gradual improving operating environment for core e-commerce business
- Undemanding valuation presents an entry point for long-term investors

**Restructuring to enhance shareholders' return.** The Company plans to fully divest its Cloud business via stock dividend distribution to shareholders within 12 months. For businesses with less synergy with core e-commerce business, such as Digital media and Entertainment, we believe Alibaba might follow a similar route to divest all/most stakes. For business units with higher e-commerce synergies (Cainiao/local services/global digital commerce), Alibaba will likely maintain a sizable ownership after their respective IPOs. Overall, potential room for enhancing shareholders' return will depend on the fund raised via future IPOs/asset disposal.

**Near-term business outlook.** Online physical goods GMV growth on Taobao and Tmall turned positive in Mar vs. c. 5% decline in 1Q23, driven by Fashion & accessories and Healthcare products. The recovery trend extended into Apr. We expect an improving operating environment in coming quarters and FY3/23-25E revenue CAGR of 10%.

**A valuation play.** Maintain **BUY** with SOTP-based TP at HK\$ 130 for Alibaba-SW (9988 HK) and US\$ 132 for Alibaba-ADR (BABA US). We believe its current valuation at about 9.5x FY24E core P/E presents an entry point for long-term investors. Compared with major online platforms such as Tencent (700 HK), Alibaba's current valuation also represents a good relative value. In addition, we estimate that SoftBank's stake in Alibaba is now below 2%, which reduces the technical overhang for the counter.

### Results and Valuation

FY end Mar 31	FY22A	FY23A	FY24E	FY25E
Revenue (RMB mn)	853,062	868,687	942,779	1,052,097
Chg (% YoY)	18.9	1.8	8.5	11.6
Net profit (RMB mn)	61,959	72,509	108,008	122,465
Chg (% YoY)	(58.8)	17.0	49.0	13.4
Core net profit (RMB mn)	143,515	143,991	155,829	174,724
Chg (% YoY)	(19.8)	0.3	8.2	12.1
Underlying EPS (RMB)	2.9	3.5	5.1	5.8
Chg (% YoY)	(58.7)	20.3	49.0	13.4
Core EPS (RMB)*	6.6	6.8	7.4	8.3
Chg (% YoY)	(19.1)	3.5	8.2	12.1
Core P/E (x)- ADR*	10.5	10.2	9.4	8.4
Core P/E (x)-SW share*	10.6	10.3	9.5	8.5
ROAE (%)	5.8	6.6	9.2	9.3
ROAA (%)	3.7	4.2	5.9	6.1

1 ADR = 8 ordinary shares

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

Source (s): Bloomberg, ABCI Securities estimates

## Company Report May 31, 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\$78.6/ HK\$77.9
Est. share price return	66.9%/68.8%
Est. dividend yield	NA/NA
Est. total return	66.9%/68.8%
Last Rating & TP	US\$132/ HK\$130

Previous Report Date Mar 1, 2023

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)	20,651
Market cap (HK\$ mn) (all share)	1,608,713
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	2.0%*

Source(s): Bloomberg, HKEx, Companies,

\*ABCI Securities estimates



## Recent business update

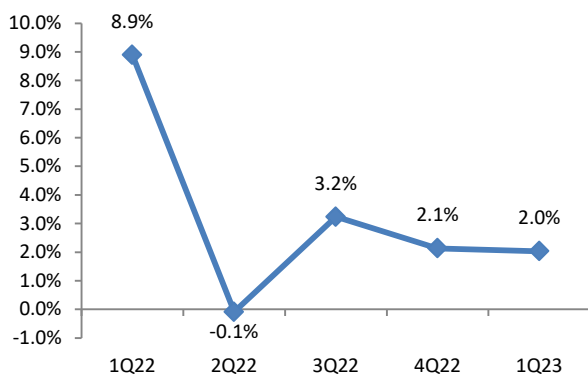
In 1Q23 (4QFY3/23), Alibaba's revenue increased 2% YoY to RMB 208bn, in line with market expectation. Core net profit rose 30% YoY to RMB 27.9bn, 14% above market expectation on better-than-expected cost control.

China commerce revenue declined 2.9% YoY during the quarter vs. the 1.1% YoY decline in the previous quarter on rising COVID cases. GMV of Taobao and Tmall dropped by c. 5% during the quarter. On a positive note, online physical goods GMV growth on Taobao and Tmall turned positive in Mar, driven by Fashion & accessories and Healthcare categories, and the recovery trend extended into Apr. International commerce, Cainiao, and Local consumer services gained 29%/18%/17% YoY in revenue in 1Q23. Cloud computing revenue dropped 2% YoY during the quarter mainly due to project delays amid COVID outbreak.

Core net margin was 13.4% in 1Q23 vs. 10.5% in 1Q22 thanks to ongoing cost optimization initiatives. Adjusted EBITA margin of loss-making segments such as local consumer services, innovation initiatives, etc. narrowed from -20% in 1Q22 to -13% in 1Q23, while adjusted EBITA of China commerce improved from 23% in 1Q22 to 28% in 1Q23.

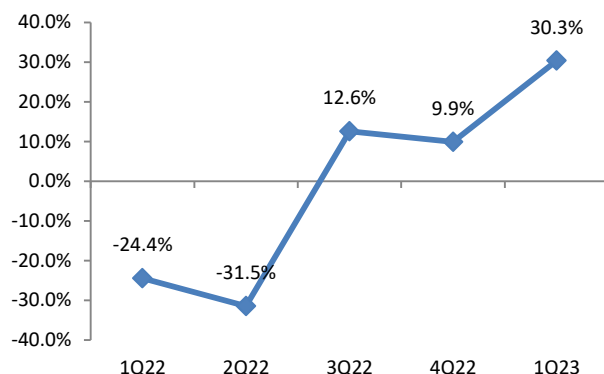
Regarding its corporate restructuring plan, the Company plans to conduct (a) a full spin-off of cloud business via stock dividend distribution to shareholders within 12 months; (b) IPO of 67%-owned Cainiao within 12-18 months; (c) IPO of Freshippo within 6-12 months. The Company will explore potential means to enhance shareholders' value arising from its various IPO plans, but no details have been given at this stage except for the stock dividend distribution for cloud business.

**Exhibit 1: Revenue growth trend**



Source(s): Company, ABCI Securities

**Exhibit 2: Core net profit growth trend**



Source(s): Company, ABCI Securities



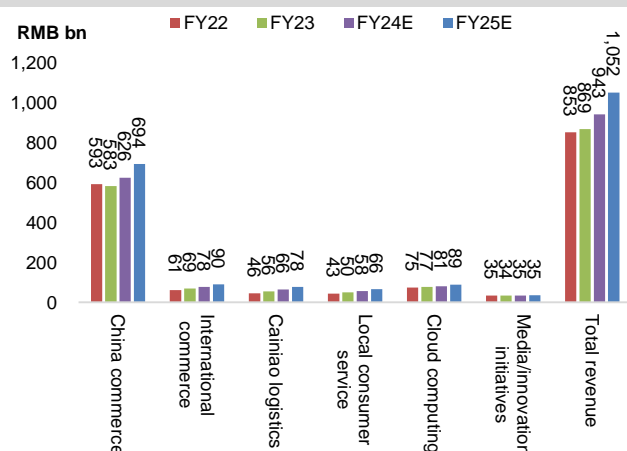
## Financial Outlook

We expect revenue to grow at 10% CAGR in FY3/23-25E.

China commerce revenue would expand at 9% CAGR in FY3/23-25E, driven by 6% CAGR in customer management revenue and 12% CAGR in direct sales and others revenue during the same period.

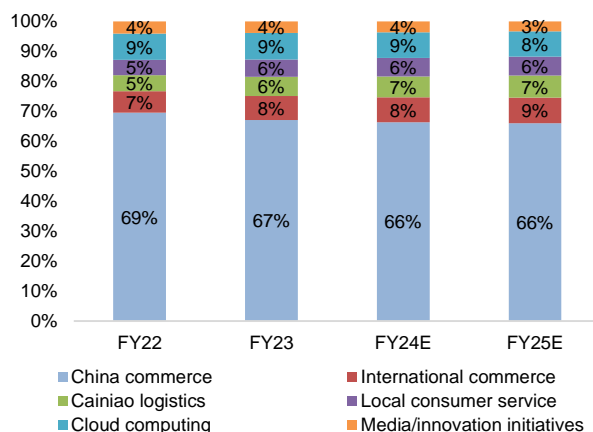
For other businesses, we expect International commerce to grow at 14% CAGR in FY3/23-25E, with Cainiao and Local consumer service expanding at 18% and 15% CAGR, respectively, in FY3/23-25E. In addition, Cloud and DME (digital media and entertainment)/innovation initiatives & others would grow at 8% and 8% CAGRs in FY3/23-25E.

Exhibit 3: Revenue outlook



Source(s): Company, ABCI Securities estimates

Exhibit 4: Revenue mix outlook



Source(s): Company, ABCI Securities estimates

**Gross margin:** We expect gross margin to rebound to 37.1% in FY3/25E vs. 36.7% in FY3/23 on better cost control.

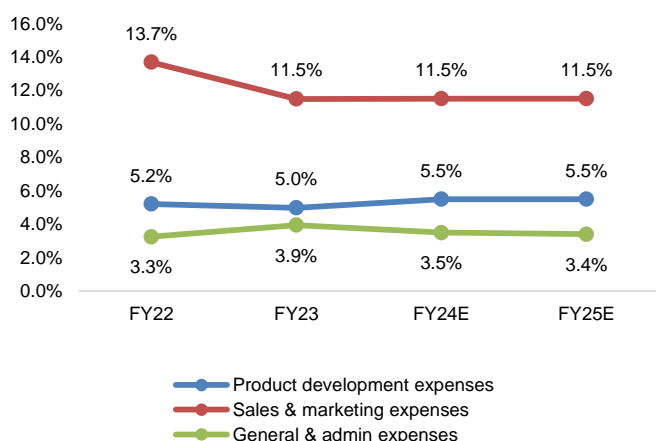
**Product development expense:** We project non-GAAP product development expenses/sales ratio at 5.5% in FY3/25E vs. 5.0% in FY3/23, indicating ongoing R&D investments in AI as well as new services for merchants and consumers to increase loyalty.

**Sales and marketing expenses:** We estimate non-GAAP sales and marketing expenses/sales ratio to maintain largely stable at 11.5% in FY3/24E and FY3/25E.

**General & admin expenses:** We expect non-GAAP general & admin expenses/sales ratio to be 3.4% in FY3/25E vs. 3.9% in FY3/23.



**Exhibit 5: Non-GAAP\* cost trend (% of revenue)**

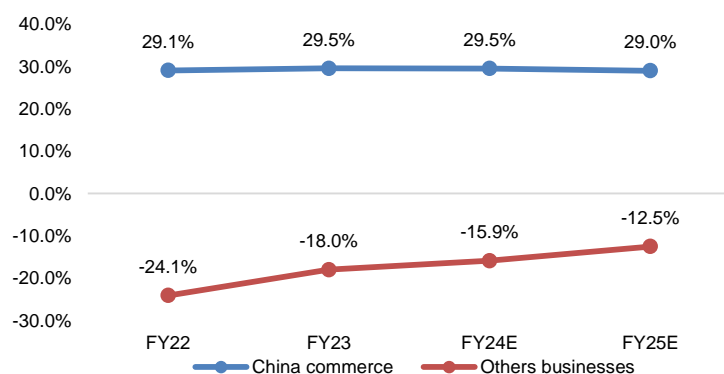


\* Excluding impacts of share-based compensation and other non-operating items

Source(s): Company, ABCI Securities estimates

The Company has made headways in cost optimization. We expect operating margin of non-China commerce businesses (International commerce, Local consumer service, Cainiao, Cloud, Media, and Innovation initiatives) to improve from -18.0% in FY3/23 to -12.5% in FY3/25E as a result of stringent cost control; in contrast, the operating margin of China commerce business would drop from 29.5% in FY3/23 to 29.0% in FY3/25E due to intensifying industry competition.

**Exhibit 6: 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 be stable at 16.6% in FY3/25E, same as that in FY3/23. This implies a FY3/23-25E core net profit CAGR of 10%.

**Exhibit 7: Forecast changes for FY3/24E**

(RMB mn)	Old	New	Diff.	Comment
Revenue	967,844	942,779	-3%	Soft consumption sentiment leading to lower China commerce revenue growth
Core profit	160,940	155,829	-3%	

Source(s): ABCI Securities estimates

**Exhibit 8: Forecast changes for FY3/25E**

(RMB mn)	Old	New	Diff.	Comment
Revenue	1,066,826	1,052,097	-1%	Higher product development expenses
Core profit	182,665	174,724	-4%	

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).

**Alibaba-SW (9988 HK):** We set our SOTP-based TP at HK\$ 130. In the SOTP, we now break down valuations of various business units versus previous DCF approach.

**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 9: SOTP-based TP for Alibaba-SW (9988 HK)

	HKD per share	Remarks
China commerce	66	8.5x FY3/24E P/E
Net cash	19	Latest book value
<b>Sub-total</b>	<b>85</b>	
Cloud	11	2.5x FY3/24E P/S
International commerce	6	1.5x FY3/24E P/S
Cainiao	5	2x FY3/24E P/S
Local consumer service	3	1.5x FY3/24E P/S
Digital media and entertainment/innovation initiatives	3	1.5x FY3/24E P/S
Investments	17	Latest book value with 30% discount
<b>Total</b>	<b>130</b>	

Source(s): ABCI Securities estimates

The Company has recently announced its plan to reorganize into six major business groups (Cloud, Taobao/Tmall, Local services, Cainiao, Global digital business, and Digital media and Entertainment), each with independent management teams and public listing potentials (except for Taobao/Tmall which will remain wholly owned).

In the near term, it plans to conduct a full spin-off of cloud business via stock dividend distribution to shareholders within 12 months, IPO of Cainiao within 12-18 months, and IPO of Freshippo within 6-12 months. IPO timelines for the remaining business units are uncertain at the moment.

Overall, the Company's decision to conduct a full spin-off of cloud business can be attributed the fact that cloud business nature is largely independent of Alibaba's core e-commerce businesses. We see a similar case for the Digital media and Entertainment business, which has limited synergies with Alibaba's core e-commerce business.

For the other businesses (Local services, Cainiao, Global digital business), Alibaba will likely maintain a majority ownership after the respective IPOs given their synergies with the core ecommerce business, therefore reducing the likelihood of full stock dividend distribution. Having said that, there are still potential to enhance shareholders' return via share repurchase or dividend post-IPO due to additional funds raised by selling new shares or existing shares.

We believe its current valuation at about 9.5x FY24E core P/E, which is approaching the low-end of historical range, presents an entry point for long-term investors.. Compared with major online platforms such as Tencent, Alibaba's current valuation also represents a good relative value. In addition, we estimate that SoftBank's stake in Alibaba is now below 2% currently and no longer presents a technical overhang for the counter.



農銀國際

ABC INTERNATIONAL

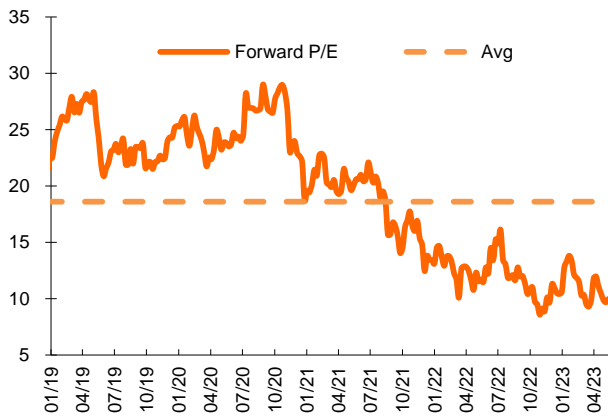
ABCI SECURITIES COMPANY LIMITED

Alibaba (9988 HK/ BABA US, BUY)

China Internet Sector

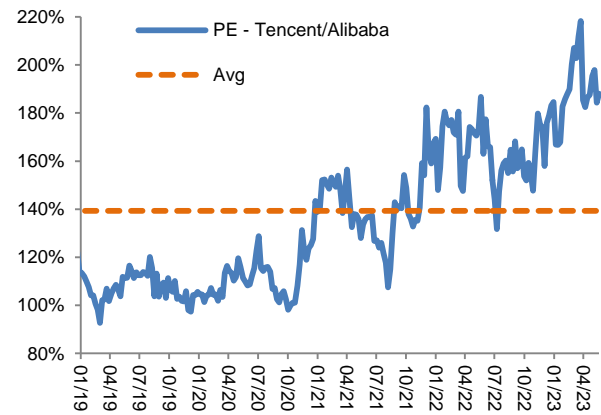
May 31, 2023

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	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>853,062</b>	<b>868,687</b>	<b>942,779</b>	<b>1,052,097</b>
Cost of sales	(539,450)	(549,695)	(596,291)	(662,276)
<b>Gross profit</b>	<b>313,612</b>	<b>318,992</b>	<b>346,488</b>	<b>389,821</b>
Product development expenses	(55,465)	(56,744)	(66,316)	(74,006)
Selling & marketing expenses	(119,799)	(103,496)	(112,390)	(125,422)
General & admin expenses	(31,922)	(42,183)	(41,449)	(45,203)
Amortization/Impairment	(36,788)	(16,218)	(14,142)	(14,729)
<b>Operating Profits</b>	<b>69,638</b>	<b>100,351</b>	<b>112,191</b>	<b>130,460</b>
Interest and investment income	(15,702)	(11,071)	9,500	9,500
Interest expenses	(4,909)	(5,918)	(5,800)	(5,800)
Other income	10,523	5,823	5,500	5,500
Share of results of equity investees	14,344	(8,063)	5,000	5,000
<b>Profit before tax</b>	<b>73,894</b>	<b>81,122</b>	<b>126,391</b>	<b>144,660</b>
Tax	(26,815)	(15,549)	(25,278)	(28,932)
<b>Profit after tax</b>	<b>47,079</b>	<b>65,573</b>	<b>101,113</b>	<b>115,728</b>
Minority interests	15,170	7,210	7,078	6,944
Accretion of mezzanine equity	(290)	(274)	(182)	(207)
<b>Profits attributable to ordinary shareholders</b>	<b>61,959</b>	<b>72,509</b>	<b>108,008</b>	<b>122,465</b>
Share-based compensation	23,971	30,831	32,997	36,823
Amortization and impairment	51,911	37,855	24,142	24,729
Gains on disposals/revaluation of investments	21,671	13,857	(9,500)	(9,500)
Other non-core items	(15,997)	(11,061)	182	207
<b>Non-GAAP profits attributable to ordinary shareholders (Core net profit)</b>	<b>143,515</b>	<b>143,991</b>	<b>155,829</b>	<b>174,724</b>
<b>Growth</b>				
Total revenue (%)	18.9	1.8	8.5	11.6
Gross Profits (%)	5.9	1.7	8.6	12.5
Operating Profits (%)	(22.3)	44.1	11.8	16.3
Net profit (%)	(58.8)	17.0	49.0	13.4
Core net profit (%)	(19.8)	0.3	8.2	12.1
<b>Operating performance</b>				
Operating margin (%)	8.2	11.6	11.9	12.4
Net margin (%)	7.3	8.3	11.5	11.6
Core net margin (%)	16.8	16.6	16.5	16.6

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	FY23A	FY24E	FY25E
Fixed assets	171,806	176,031	198,031	214,531
Investments	443,253	453,117	511,117	569,117
Other non-current assets	441,959	425,930	463,788	501,059
<b>Total non-current assets</b>	<b>1,057,018</b>	<b>1,055,078</b>	<b>1,172,936</b>	<b>1,284,707</b>
Cash & equivalents	189,898	193,086	190,576	252,158
Restricted cash and escrow receivables	37,455	36,424	38,245	40,157
Short-term investments and investment securities	265,187	331,384	351,384	371,384
Prepayments, deposits & other assets	145,995	137,072	150,779	165,857
<b>Total current assets</b>	<b>638,535</b>	<b>697,966</b>	<b>730,984</b>	<b>829,556</b>
<b>Total assets</b>	<b>1,695,553</b>	<b>1,753,044</b>	<b>1,903,921</b>	<b>2,114,263</b>
Accrued expenses, accounts payable and other liabilities	271,460	275,950	271,210	302,658
Other payables & accruals	21,753	12,543	13,170	13,829
Borrowings and notes	8,841	12,266	20,266	28,266
Deferred revenue	66,983	71,295	75,422	84,168
Merchants deposits	14,747	13,297	13,962	14,660
<b>Total current liabilities</b>	<b>383,784</b>	<b>385,351</b>	<b>394,031</b>	<b>443,580</b>
Borrowings and notes	132,503	149,088	154,088	159,088
Other non-current liabilities	97,073	95,684	98,771	102,013
<b>Total non-current liabilities</b>	<b>229,576</b>	<b>244,772</b>	<b>252,859</b>	<b>261,101</b>
<b>Total liabilities</b>	<b>613,360</b>	<b>630,123</b>	<b>646,890</b>	<b>704,681</b>
<b>Net current assets</b>	<b>254,751</b>	<b>312,615</b>	<b>336,954</b>	<b>385,976</b>
<b>Mezzanine equity</b>	<b>9,655</b>	<b>9,858</b>	<b>10,040</b>	<b>10,247</b>
Equity attributable to shareholders	948,479	989,657	1,130,662	1,289,951
Non-controlling interests	124,059	123,406	116,328	109,384
<b>Total equity</b>	<b>1,072,538</b>	<b>1,113,063</b>	<b>1,246,991</b>	<b>1,399,335</b>

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	65,573	101,113	115,728
Depreciation and amortization	48,065	41,004	42,142	43,229
Other non-cash adjustments	65,765	82,819	27,997	31,823
Change in working capital	(18,150)	10,356	(11,761)	27,801
<b>Operating cash flow</b>	<b>142,759</b>	<b>199,752</b>	<b>159,490</b>	<b>218,582</b>
<b>Investing cash flow</b>	<b>(198,592)</b>	<b>(135,506)</b>	<b>(175,000)</b>	<b>(170,000)</b>
<b>Financing cash flow</b>	<b>(64,449)</b>	<b>(65,619)</b>	<b>13,000</b>	<b>13,000</b>
<b>Net cash flows</b>	<b>(120,282)</b>	<b>(1,373)</b>	<b>(2,510)</b>	<b>61,582</b>

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



## 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.



## Disclosures

### Analyst Certification

The analyst, CHOW Sau Shing, 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 have no financial interests in relation to the listed company(ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (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 Alibaba and Tencent.

### 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.

### 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 2023 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