

## Alibaba (9988 HK/BABA US)

### Reposition to enhance competitiveness

- Reposition towards “value-to-money” segment to enhance competitiveness
- Ongoing profitability improvement to support profit growth
- Undemanding valuation presents an entry point for long-term investors

**Reposition to enhance competitiveness.** In 2Q23, Taobao and Tmall revenue grew 12% YoY. In addition, customer management revenue went up 10% YoY after the 5% YoY decline in 1Q23. While the rebound was partly a result of low base last year, we believe the increase was also driven by enhanced price competitiveness and marketing effectiveness, among others. Alibaba’s strategy to refocus on the “value for money” segment could help mitigate the soft consumer sentiment and industry competition.

**Ongoing profitability improvement.** In 2Q23, profitability of most business segments went up - international digital commerce and local service reported 70% YoY and 30% YoY reduction in adjusted EBITA losses, respectively, while Cainiao and Digital Media and entertainment swung into black with a positive adjusted EBITA. This mitigates a slight reduction of Taobao and Tmall’s adjusted EBITA margin from 44.1% in 2Q22 to 42.9% in 2Q23. As a result, core net margin improved from 15.3% in 2Q22 to 19.1% in 2Q23.

**Attractive valuation.** Maintain **BUY** with SOTP-based TP at HK\$ 135 for Alibaba-SW (9988 HK) and US\$ 138 for Alibaba-ADR (BABA US). With the government reiterating its support for platform enterprises, we believe the policy environment is turning favorable for major e-commerce platforms. The counter is currently trading at an attractive valuation of 9.4x FY25E core P/E.

#### 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	113,928	122,465
Chg (% YoY)	(58.8)	17.0	57.1	7.5
Core net profit (RMB mn)	143,515	143,991	161,760	174,724
Chg (% YoY)	(19.8)	0.3	12.3	8.0
Underlying EPS (RMB)	2.9	3.5	5.6	6.0
Chg (% YoY)	(58.7)	20.3	60.9	7.5
Core EPS (RMB)*	6.6	6.8	7.8	8.5
Chg (% YoY)	(19.1)	3.5	15.1	8.0
Core P/E (x)- ADR*	12.4	12.0	10.4	9.6
Core P/E (x)-SW share*	12.1	11.7	10.2	9.4
ROAE (%)	5.8	6.6	9.6	9.2
ROAA (%)	3.7	4.2	6.2	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

### Aug 18, 2023

### Rating: BUY

Rating (SW-share): BUY

TP (SW-share): HK\$ 135

Rating (ADR): BUY

TP (ADR): US\$ 138

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Price (ADR/SW-share)	US\$90.6/ HK\$86.6
Est. share price return ( ADR/SW-share )	52.4%/55.8%
Est. dividend yield ( ADR/SW-share )	NA/NA
Est. total return (ADR/SW-share )	52.4%/55.8%
Last Rating & TP (ADR/SW-share )	US\$132/ HK\$130

Previous Report Date May 31, 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)	20,400
Market cap (HK\$ mn) (based on SW-share price)	1,767,660
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 2Q23 (1QFY3/24), Alibaba's revenue increased by 14% YoY to RMB 234bn, indicating a sequential improvement vs. the 2% growth in the previous quarter. Core net profit increased by 43% YoY to RMB 44.7bn, with core net margin improving to 19.1% vs. 13.4% in the previous quarter.

Among its major business segment, revenue from Taobao and Tmall grew 2% YoY in 2Q23. In addition, customer management revenue went up 10% YoY vs. the 5% YoY decline in 1Q23. In our view, the rebound was driven by low base as well as improved price competitiveness and effective marketing, especially during the 618 shopping festival. In Jun, Taobao's DAU increased by 6.5% YoY. International digital commerce revenue jumped 41% YoY, driven by the 25% order growth of its various retail platforms such as AliExpress, Lazard, and Trendyol. Local service and Cainiao also reported strong revenue growth of 30% YoY and 34% YoY during the quarter.

In contrast, Cloud intelligence's revenue growth remained weak at 4% YoY during the quarter due to ongoing business adjustment of project-based cloud services. Having said that, Alibaba Cloud has made headways in AI development and introduced several AI models during the quarter.

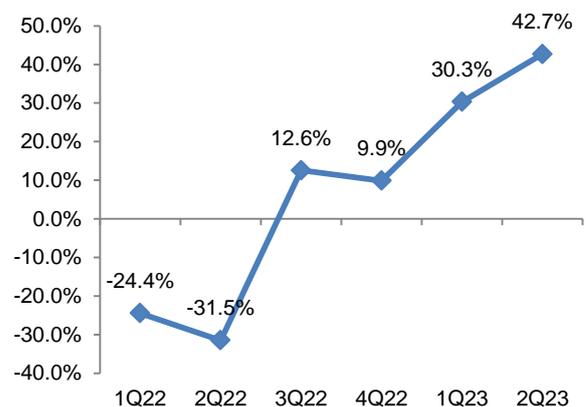
In terms of segment profitability, adjusted EBITA margin of Taobao and Tmall went down from 44.1% in 2Q22 to 42.9% in 2Q23, which we believe could be attributed to increased promotions. On a positive note, international digital commerce and local service showed 70% YoY and 30% YoY reduction in adjusted EBITA losses, respectively, while Cainiao and Digital Media and entertainment turned around to show a positive adjusted EBITA during the quarter. As a result, segment adjusted EBITA margin improved from 17.2% in 2Q22 to 18.8% in 2Q23, while core net margin improved from 15.3% in 2Q22 to 19.1% in 2Q23.

Exhibit 1: Revenue growth trend



Source(s): Company, ABCI Securities

Exhibit 2: Core net profit growth trend



Source(s): Company, ABCI Securities

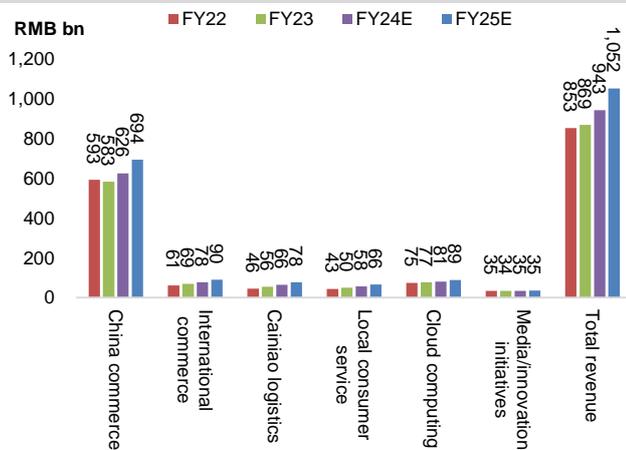
## Financial Outlook

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.

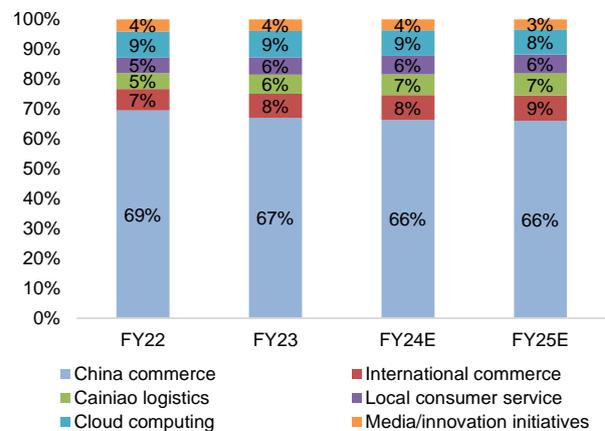
For other businesses, we expect International commerce to grow at 14% CAGR in FY3/23-25E, with Cainiao and Local consumer service expanding at 18% and 15% CAGR, respectively, in FY3/23-25E. In addition, Cloud and DME (digital media and entertainment)/innovation initiatives & others would grow at 8% and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

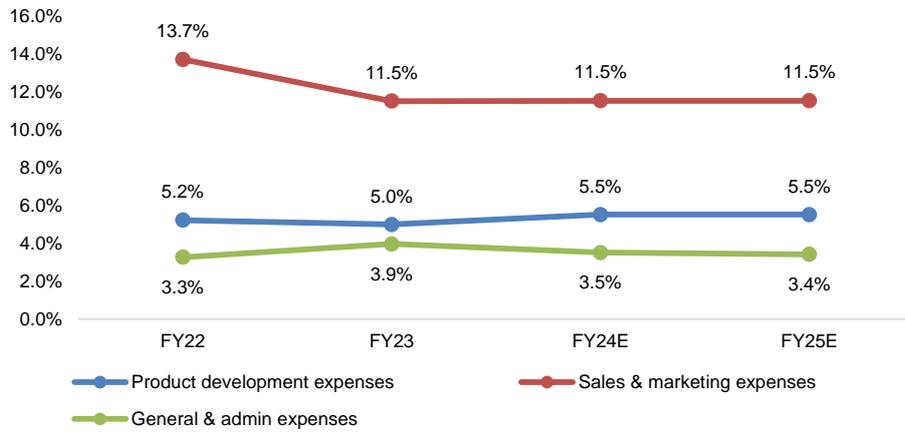
**Product development expense:** We project non-GAAP product development expenses/sales ratio at 5.5% in FY3/25E vs. 5.0% in FY3/23, indicating ongoing R&D investments in AI as well as new services for merchants and consumers to increase loyalty.

**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

We expect core net margin (excl. impacts of share-based compensation and other non-operating items) to be 16.6% in FY3/25E, same as that in FY3/23. This implies a FY3/23-25E core net profit CAGR of 10%.

Exhibit 6: Forecast changes for FY3/24E

(RMB mn)	Old	New	Diff.	Comment
Revenue	942,779	942,779	0%	--
Core profit	155,829	161,760	4%	Margin improvement

Source(s): ABCI Securities estimates

Note: FY3/25E forecast remains unchanged

## Valuation and TP

Maintain **BUY** with revised SOTP-based TP at HK\$ 135 for Alibaba-SW (9988 HK) and US\$ 138 for Alibaba-ADR (BABA US). Our TP implies 14.6x FY3/25E core P/E.

**Exhibit 7: SOTP-based TP for Alibaba-SW (9988 HK)**

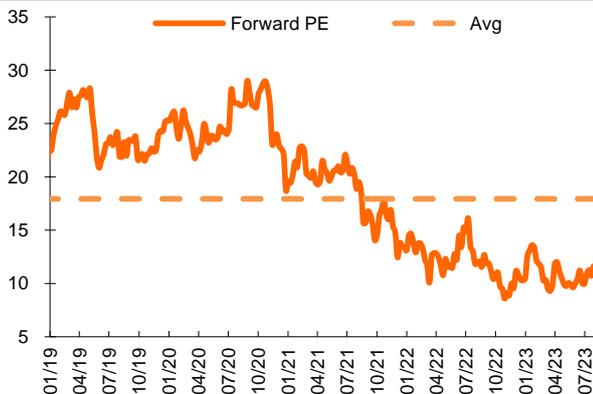
	HKD per share	Remarks
China commerce	69	8x FY3/25E P/E
Cloud	12	2.5x FY3/25E P/S
International commerce	7	1.5x FY3/25E P/S
Cainiao	5	2x FY3/25E P/S
Local consumer service	4	1.5x FY3/25E P/S
Digital media and entertainment/innovation initiatives	3	1.5x FY3/25E P/S
Investments	17	Latest book value with 30% discount
Net cash	18	Latest book value
<b>Total</b>	<b>135</b>	

Source(s): ABCI Securities estimates

The government has recently reiterated its support for platform enterprises. In our view, the policy environment is turning favorable for major e-commerce platforms. The counter is current valuation at about 9.4x FY25E core P/E, which is still attractive and presents an entry point for long-term investors, in our view.

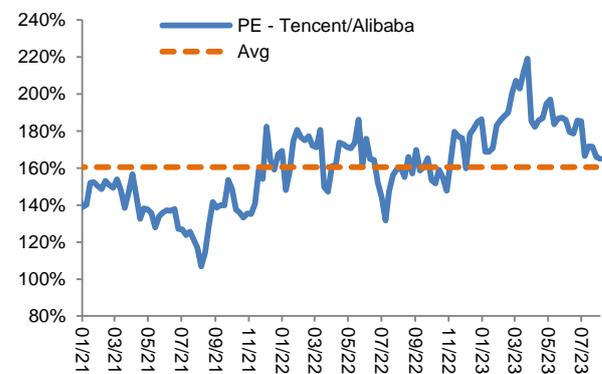
In addition, under its reorganization plan where spin-off/IPOs of its various business units might occur, shareholders' return could increase via share repurchase or dividends post-IPO due to additional funds raised by selling new or existing shares.

**Exhibit 8: Alibaba's fwd. core P/E**



Source(s): Bloomberg, ABCI Securities

**Exhibit 9: Relative value vs. 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)	(586,863)	(662,276)
<b>Gross profit</b>	<b>313,612</b>	<b>318,992</b>	<b>355,916</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>121,618</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)	2,500	5,000
<b>Profit before tax</b>	<b>73,894</b>	<b>81,122</b>	<b>133,318</b>	<b>144,660</b>
Tax	(26,815)	(15,549)	(26,664)	(28,932)
<b>Profit after tax</b>	<b>47,079</b>	<b>65,573</b>	<b>106,655</b>	<b>115,728</b>
Minority interests	15,170	7,210	7,466	6,944
Accretion of mezzanine equity	(290)	(274)	(192)	(207)
<b>Profits attributable to ordinary shareholders</b>	<b>61,959</b>	<b>72,509</b>	<b>113,928</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)	192	207
<b>Non-GAAP profits attributable to ordinary shareholders (Core net profit)</b>	<b>143,515</b>	<b>143,991</b>	<b>161,760</b>	<b>174,724</b>
<b>Growth</b>				
Total revenue (%)	18.9	1.8	8.5	11.6
Gross Profits (%)	5.9	1.7	11.6	9.5
Operating Profits (%)	(22.3)	44.1	21.2	7.3
Net profit (%)	(58.8)	17.0	57.1	7.5
Core net profit (%)	(19.8)	0.3	12.3	8.0
<b>Operating performance</b>				
Operating margin (%)	8.2	11.6	12.9	12.4
Net margin (%)	7.3	8.3	12.1	11.6
Core net margin (%)	16.8	16.6	17.2	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	508,617	566,617
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>1,170,436</b>	<b>1,282,207</b>
Cash & equivalents	189,898	193,086	198,618	260,200
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>739,027</b>	<b>837,599</b>
<b>Total assets</b>	<b>1,695,553</b>	<b>1,753,044</b>	<b>1,909,463</b>	<b>2,119,806</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>344,996</b>	<b>394,018</b>
<b>Mezzanine equity</b>	9,655	9,858	10,050	10,257
Equity attributable to shareholders	948,479	989,657	1,136,583	1,295,871
Non-controlling interests	124,059	123,406	115,940	108,996
<b>Total equity</b>	<b>1,072,538</b>	<b>1,113,063</b>	<b>1,252,523</b>	<b>1,404,867</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	FY23A	FY24E	FY25E
Net income	47,079	65,573	106,655	115,728
Depreciation and amortization	48,065	46,938	42,142	43,229
Other non-cash adjustments	65,765	123,759	30,497	31,823
Change in working capital	(18,150)	(36,518)	(11,761)	27,801
<b>Operating cash flow</b>	<b>142,759</b>	<b>199,752</b>	<b>167,532</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>5,532</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.

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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 averaged 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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