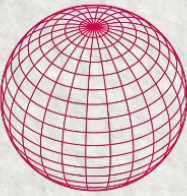


CASE  STUDY

VALUATION MASTER CLASS

by  INVESTMENT  
RESEARCH

# Can **Alibaba** continue to maintain its **dominant position?**



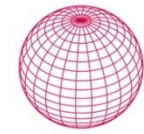
**Valuation Master Class**



What's interesting  
about **Alibaba** is  
that its **GMV** is  
twice that of  
**Amazon**



**Valuation Master Class**



Sector: Cons. Disc.



*E-commerce company with the largest gross merchandise value at \$1.3trillion*

**Our estimate:**

**HKD127**

(Upside 27%)

**BUY**



## 3 things to know about this company

- ★ Shifting to New Retail strategy to drive top-line growth
- ★ New Retail strategy provides growth but comes at a cost
- ★ Superior market share means profit beats its closest rival

## Key statistics

Analyst consensus (33)

**HKD151**

(Upside 50%)

**BUY**

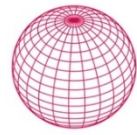
PE ratio (22A)

**26x**

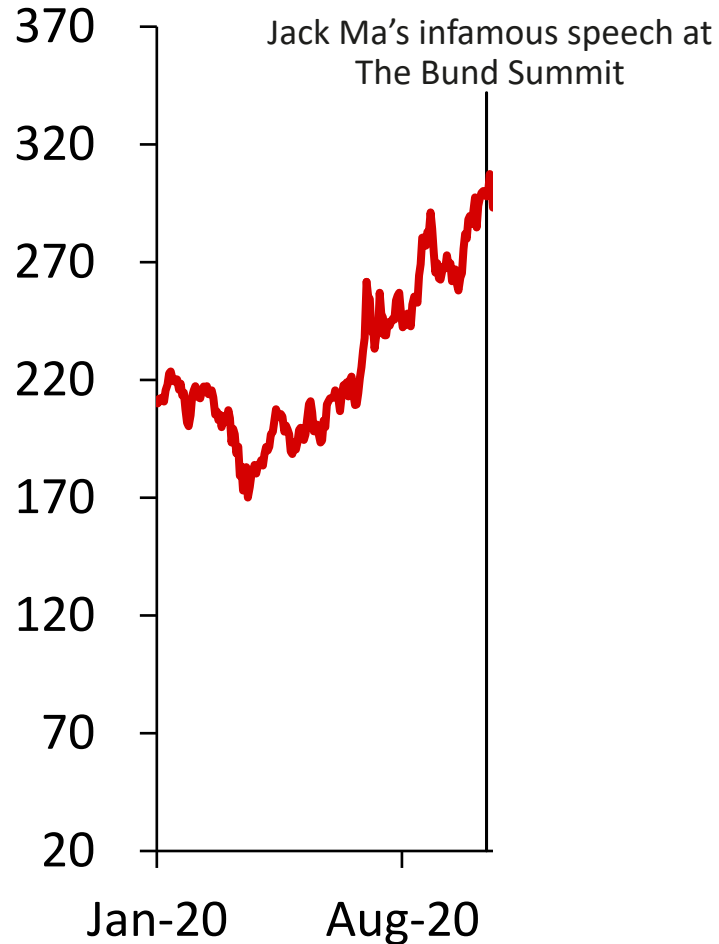
Dividend yield

**0%**

# A speech that crashed the share price

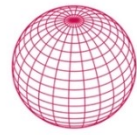


## Alibaba's share price (HKD)

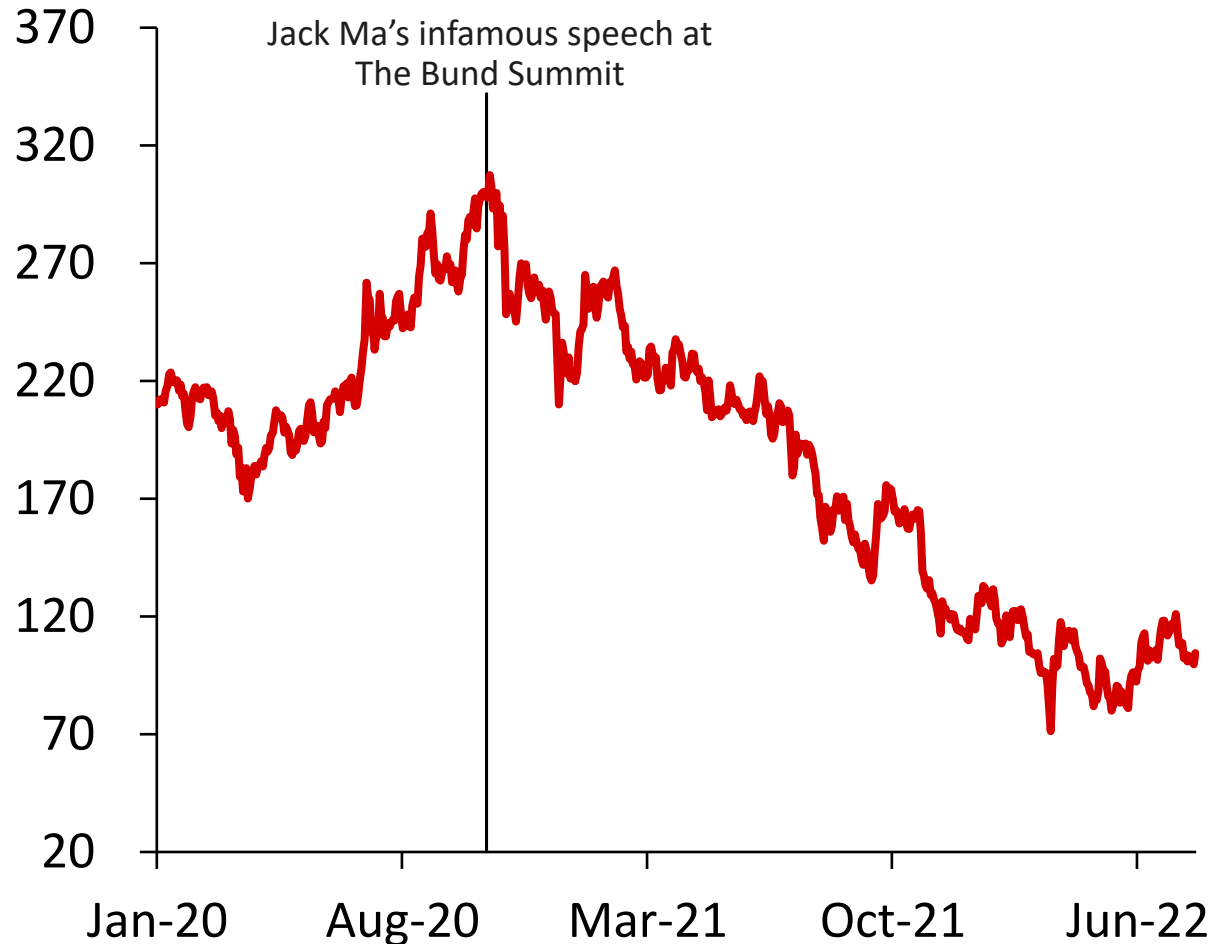


- ★ Back in the late 2020, Jack Ma gave a speech criticizing China's banking system as being inefficient
  - **The speech led to Chinese government's realization that China's big techs are wielding too much power**
- ★ The Chinese government responded with an immediate cancellation of Ant Group's IPO and a series of Anti- fines

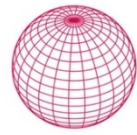
# A speech that crashed the share price



## Alibaba's share price (HKD)

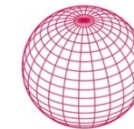


- ★ Back in the late 2020, Jack Ma gave a speech criticizing China's banking system as being inefficient
  - The speech led to Chinese government's realization that China's big techs are wielding too much power
- ★ The Chinese government responded with an immediate cancellation of Ant Group's IPO and a series of Anti-fines
  - As a result, Alibaba's share price crashed by 72%



- ★ **Ant Group:** The company has been restructured into a financial holdings company, which subjects the company to regulations that applies to financial institutions
  - **Alibaba and Ant group has terminated data sharing agreement**
  - **There are no plans to revive the IPO of Ant Group**
  - **And Alibaba currently holds a 33% stake of Ant Group**
- ★ **Hong Kong primary listing:** Hong Kong Stock Exchange has approved Alibaba's primary listing
  - **Gaining primary listing in Hong Kong would make Alibaba eligible to take part in stock connect with Mainland China**
  - **This would give access to qualified Mainland Chinese investors to access Alibaba's shares**





Sales

Story

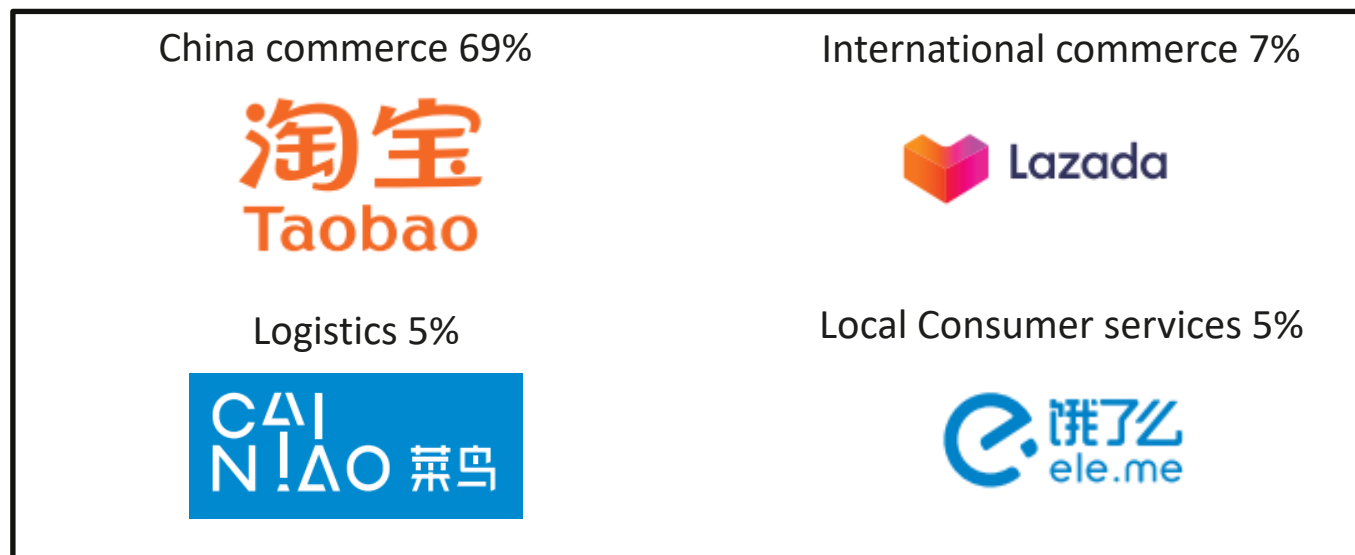
FVMR

Value

WCB

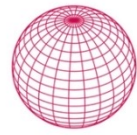
Risks

## Core commerce segment 86%



## Other segment 14%





## China Commerce

Customer Management



Direct Sale



Logistics



Takes care of supply chain optimization

Local Consumer Services



Enables on-demand delivery of meals and groceries

Cloud

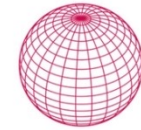


Handles digitalization of supermarkets

- ★ The main revenue driver is the China Commerce segment and can be divided into:
  - **Customer management (E-commerce platform)**
  - **Direct Sale (E-grocery)**
- ★ The China Commerce segment is supported by: Logistics, Local Consumer Service and Cloud segments which help build Alibaba's ecosystem



# 1 Shifting to New Retail strategy to drive top-line growth

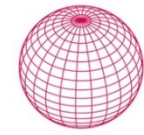


- Sales
- Story
- FVMR
- Value
- WCB
- Risks

- ★ Alibaba’s Sun Art, Tmall Supermarket and Freshhippo subsidiaries are instrumental in driving the growth of New Retail strategy
  - **The concept is to blur the line between online and offline retail**
- ★ Today, all of Alibaba’s subsidiaries’ physical supermarkets and hypermarkets are integrated into Alibaba’s platform
  - **This enables a less-than-one-hour delivery to customers through Alibaba’s ecosystem**



# Direct sales to become a new revenue growth engine



Sales

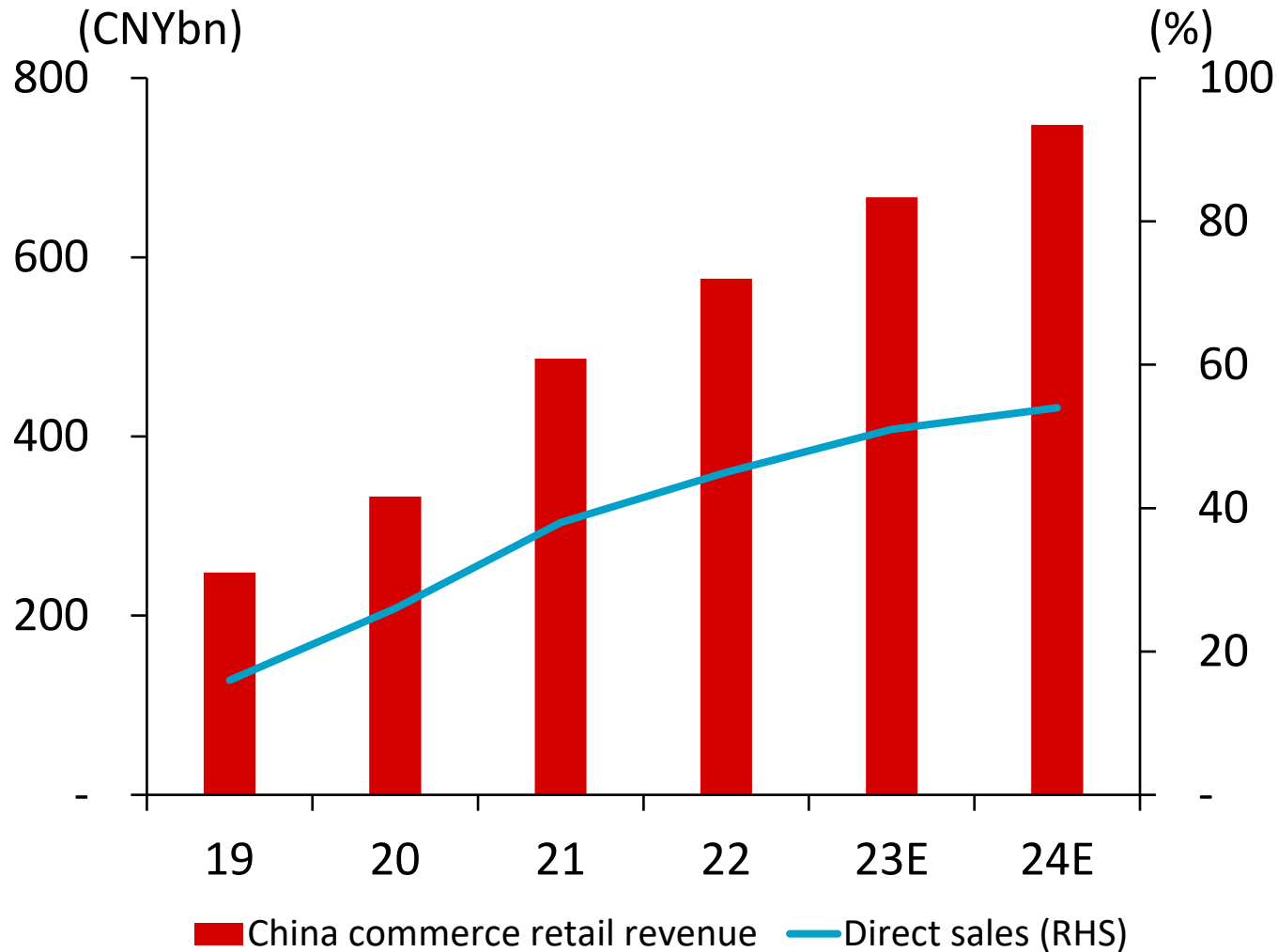
Story

FVMR

Value

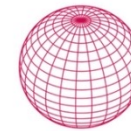
WCB

Risks



- ★ Direct sales already account for 45% of China commerce segment in 2022 compared to just 16% in 2019
  - **The explosive growth was driven by the pandemic**
- ★ Digital grocery sales in China reached nearly \$200bn in 2021
  - **And the market size is expected to almost double in 2025**

## 2 New Retail strategy provides growth but comes at a cost



Sales

Story

FVMR

Value

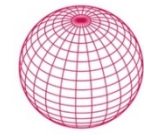
WCB

Risks

- ★ Alibaba's traditional driver of revenue growth has been its e-commerce platforms
  - **By being the facilitator of exchange between buyers and sellers, Alibaba traditionally has low inventory costs to its revenue**
- ★ With the surge of revenue contribution coming from direct sale segment, Alibaba has increased its inventory cost that came from operating supermarkets
  - **The consequence of this is the decline in gross profit margin**



# Gross margin has consistently been on a decline



Sales

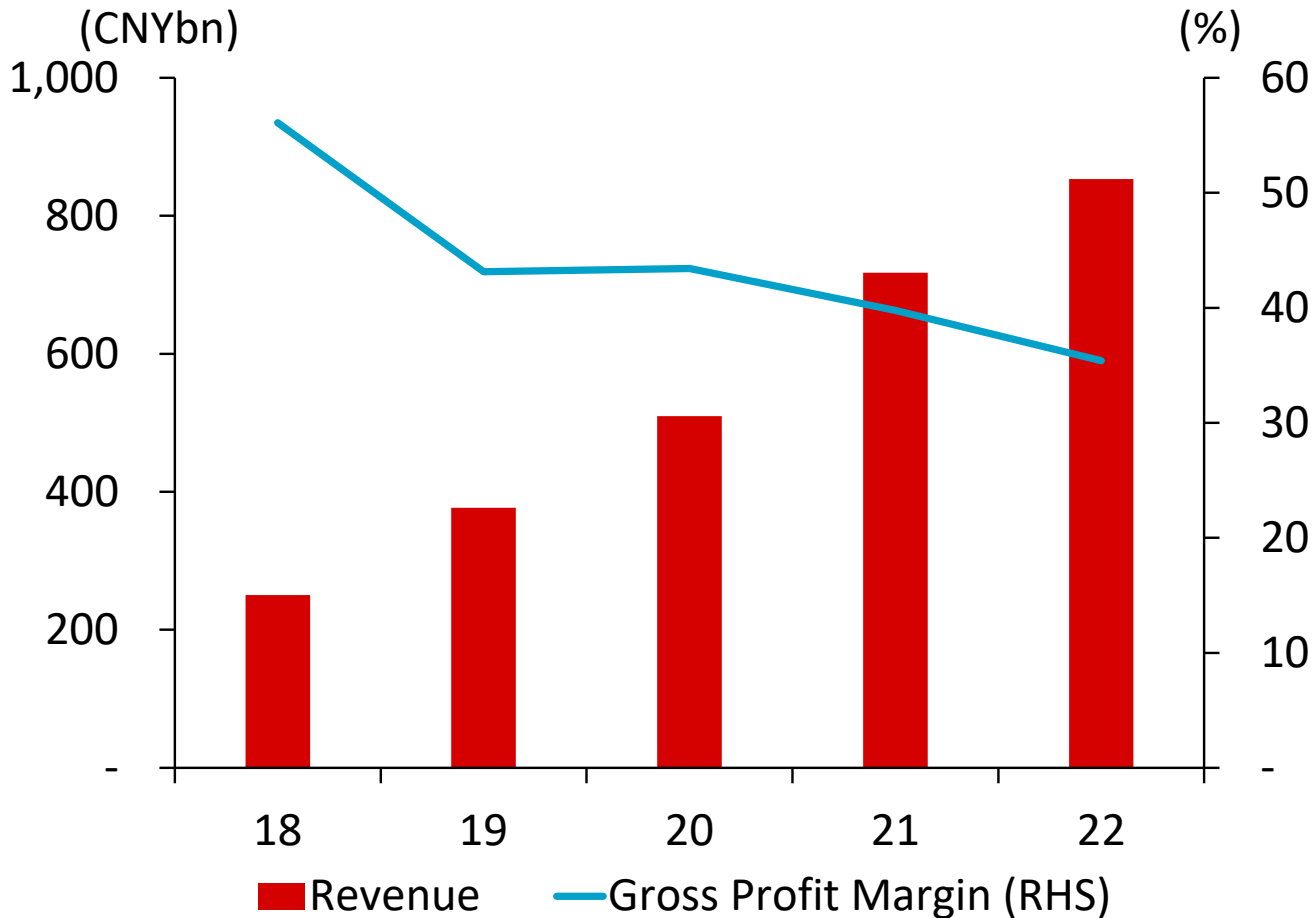
Story

FVMR

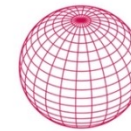
Value

WCB

Risks



- ★ In 2022, Alibaba's cost of revenue increased by 28%
  - **Alibaba attributes this to the consolidation of Sun Art which increased the cost of inventory**
  - **And the growing expansion of Taocaicai which increases the logistic costs**
- ★ Alibaba plans to continue investing in direct sales segment which it expects further decline in margin



Sales



Story

FVMR

Value

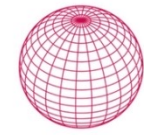
WCB

Risks

	 <b>JD.COM</b>	 <b>Alibaba</b>
<b>5-yr average</b>		
Revenue CAGR	22.4	27.8
Gross margin	14.2	43.6
EBIT margin	0.6	17.9
Net margin	1.6	21.3
Asset turnover	200	46
Assets/equity	2.5	2.5
ROE	5.8	24.3
ROIC	6	17

- ★ In 2021, Alibaba has a market share of 47% of China's retail ecommerce sale
  - While its closest rival, JD.com has a market share of 17%
- ★ This allows Alibaba to outperform JD.com on profitability measurements
- ★ The risk now for Alibaba is that it falls from its position
  - While JD.com has room to improve

# Consistent value creation compared to rival



Sales

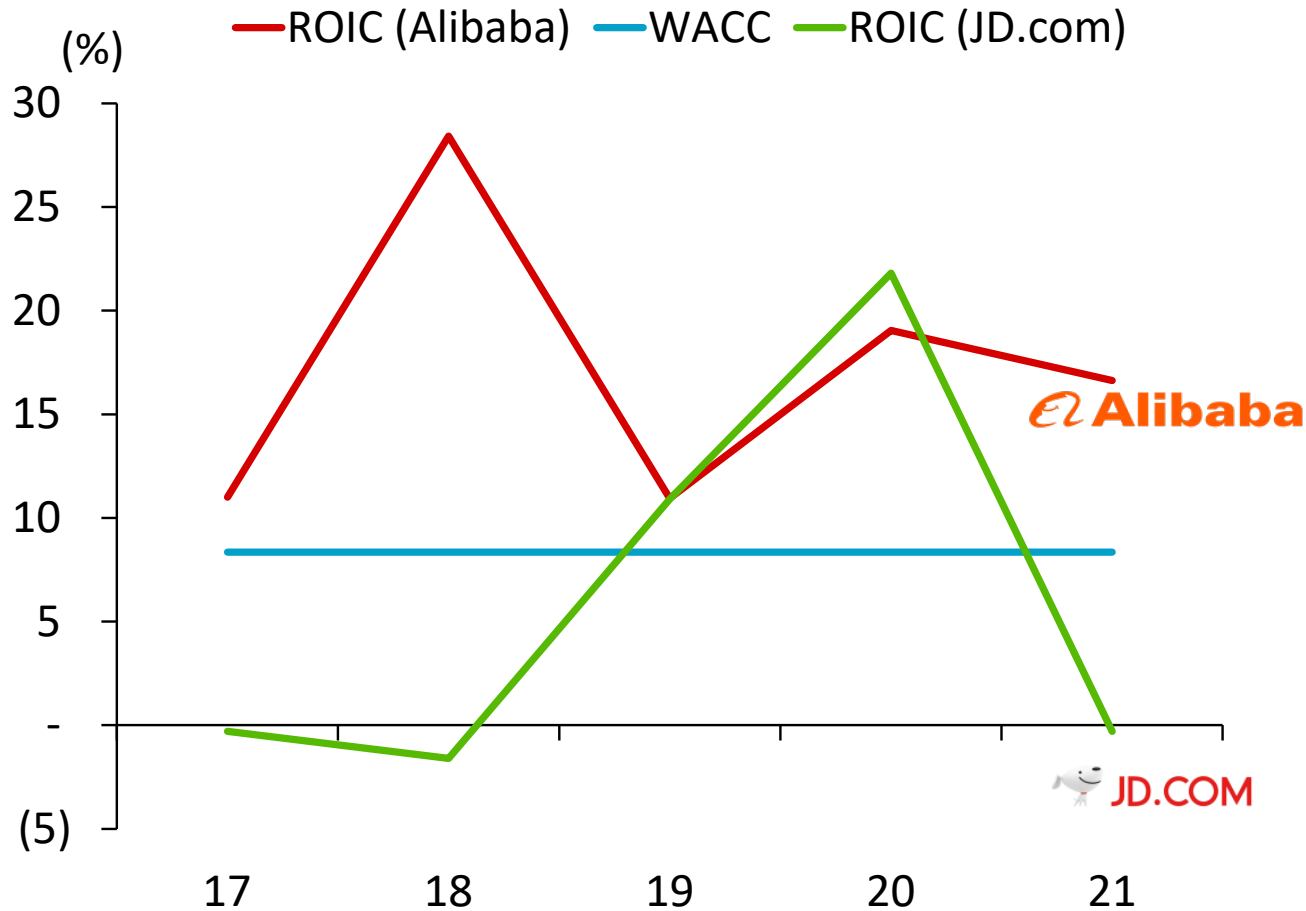
Story

FVMR

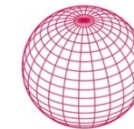
Value

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Risks



- ★ Unlike JD.com, Alibaba has consistently deliver value to its creditors and shareholders
  - **Alibaba's superior ROIC is attributable to its higher profitability**
  - **And Alibaba has more robust ecosystem compared to its rival**
- ★ Despite anti-monopoly regulations, it is unlikely that JD.com will catch to Alibaba soon



Sales

Story

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Value

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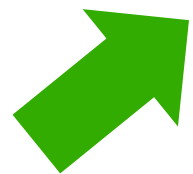
Risks

## Analyst consensus valuation

Recommendation	Apr-22	May-22	Jun-22	Current
Strong buy	11	11	12	13
Buy	18	19	18	18
Hold	3	3	3	2
Sell	1	-	-	-
Strong sell	-	-	-	-
<b>Average score</b>	<b>1.8</b>	<b>1.8</b>	<b>1.7</b>	<b>1.7</b>

Price target	Apr-22	May-22	Jun-22	Current
Median	155	146	146	148
Mean	126	126	123	116

**33**  
analysts

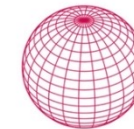


Upside: 50%

## Analyst consensus 3-year forecast

	Consensus forecast					
(%)	20	21	22	23E	24E	25E
Revenue growth	35.3	40.7	18.9	7.3	13.0	10.4
Gross margin	43.4	42.8	35.4	35.1	36.1	35.4
EBIT margin	19.7	23.8	11.1	13.9	14.2	15.3
Net margin	29.3	24.9	7.2	14.7	15.2	15.5

- ★ Most analysts are bullish on Alibaba
- ★ Analysts predict lower gross margin compared to historical average
  - This is in line with our forecast due to Alibaba consolidating subsidiaries with higher inventory costs



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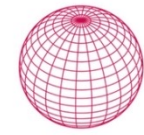
WCB

Risks

(YE Mar, RMB m)	2021A	2022A	2023E	2024E
Revenue	717,289	853,062	921,307	1,050,290
Cost of goods & services	(431,944)	(551,097)	(598,850)	(682,688)
<b>Gross profit</b>	<b>285,345</b>	<b>301,965</b>	<b>322,457</b>	<b>367,601</b>
SG&A	(193,979)	(207,186)	(230,327)	(252,070)
Other operating (exp)/inc	-	-	-	-
<b>EBIT</b>	<b>91,366</b>	<b>94,779</b>	<b>92,131</b>	<b>115,532</b>
Interest expense (net)	113,632	(4,909)	77,098	80,947
Other non-operating inc/(exp)	33,563	(19,523)	19,523	35,141
<b>Earnings before taxes (EBT)</b>	<b>238,561</b>	<b>70,347</b>	<b>188,752</b>	<b>231,620</b>
Income tax	(29,278)	(26,815)	(21,563)	(28,422)
<b>Earnings after taxes (EAT)</b>	<b>209,283</b>	<b>43,532</b>	<b>167,189</b>	<b>203,198</b>
Equity income/Minority interest	14,008	29,224	27,750	30,049
<b>Earnings from cont. operations</b>	<b>223,291</b>	<b>72,756</b>	<b>194,939</b>	<b>233,247</b>
Forex/Exceptionals before tax	(72,983)	(10,797)	(53,985)	(53,985)
<b>Net profit</b>	<b>150,308</b>	<b>61,959</b>	<b>140,954</b>	<b>179,262</b>

- ★ Revenue growth is expected to be disrupted by zero covid policy which disrupts supply chain and logistics





Sales

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Value

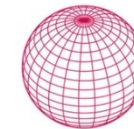
WCB

Risks

(YE Mar, RMB m)	2021A	2022A	2023E	2024E
Cash & short-term investments	483,445	455,085	478,949	589,844
Accounts receivable	39,560	82,434	53,743	61,267
Inventories	27,858	30,087	31,606	36,031
Other current assets	92,497	70,929	138,196	157,543
<b>Total current assets</b>	<b>643,360</b>	<b>638,535</b>	<b>702,494</b>	<b>844,686</b>
Long-term investments	200,189	219,642	234,578	249,825
Net fixed assets	219,452	171,806	182,365	195,241
Intangible assets	70,833	59,231	62,193	62,193
Goodwill	292,771	269,581	304,627	335,089
Other long-term assets	263,613	336,758	340,126	343,527
<b>Total assets</b>	<b>1,690,218</b>	<b>1,695,553</b>	<b>1,826,381</b>	<b>2,030,560</b>

- ★ Alibaba is expanding its ecosystems which means continuous expansion of net fixed assets

# Balance sheet - liabilities



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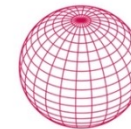
Value

WCB

Risks

(YE Mar, RMB m)	2021A	2022A	2023E	2024E
Overdrafts & short-term loans	13,437	8,841	10,382	11,005
Accounts payable	184,056	271,460	266,155	303,417
Other current liabilities	179,865	103,483	92,131	84,023
<b>Total current liabilities</b>	<b>377,358</b>	<b>383,784</b>	<b>368,668</b>	<b>398,445</b>
Long-term debt	135,716	132,503	149,337	158,297
Other long-term liabilities	93,510	97,073	98,044	99,024
<b>Total liabilities</b>	<b>606,584</b>	<b>613,360</b>	<b>616,048</b>	<b>655,766</b>
<b>Minority interest</b>	<b>137,491</b>	<b>124,059</b>	<b>111,245</b>	<b>96,444</b>
Paid-up capital - Common shares	394,309	410,507	410,507	410,507
Paid-up capital - Preferred shares	8,673	9,655	9,655	9,655
Retained earnings	562,271	573,396	714,350	893,612
Revaluation/Forex/Others	(19,110)	(35,424)	(35,424)	(35,424)
<b>Total equity</b>	<b>946,143</b>	<b>958,134</b>	<b>1,099,088</b>	<b>1,278,350</b>
<b>Total liab &amp; shareholders' equity</b>	<b>1,690,218</b>	<b>1,695,553</b>	<b>1,826,381</b>	<b>2,030,560</b>

- ★ Alibaba has low proportion of debt to its capital, this gives Alibaba an ability to expand its ecosystem



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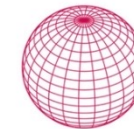
Value

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Risks

(YE Mar)	2021A	2022A	2023E	2024E
<b>General growth (YoY, %)</b>				
Revenue	40.7	18.9	8.0	14.0
Assets	28.7	0.3	7.7	11.2
Gross profit	28.9	5.8	6.8	14.0
Operating profit	(9.0)	3.7	(2.8)	25.4
Attributable profit	0.7	(58.8)	127.5	27.2
EPS	(1.6)	(58.7)	129.1	27.2
Recurring EPS	13.2	(67.2)	174.3	20.6
<b>Du Pont analysis (%)</b>				
Net profit margin	21.0	7.3	15.3	17.1
Revenue per HK\$100 of assets	47.8	50.4	52.3	54.5
Assets/equity (x)	2.4	2.6	2.4	1.6
Return on equity	24.4	9.4	19.2	15.2
<b>Others (%)</b>				
Effective tax rate	17.7	45.0	16.0	16.0
Dividend payout ratio	-	-	-	-

★ Alibaba is still not expected to pay dividends in order to continue pursuing growth



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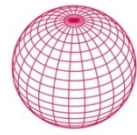
Risks

(YE Mar)	2021A	2022A	2023E	2024E
<b>Internal liquidity (x)</b>				
Current ratio	1.7	1.7	1.9	2.1
Quick, or acid test ratio	1.6	1.7	1.8	2.0
<b>Working cap. mgmt (Days)</b>				
Inventory conversion period	18	9	10	18
Receivables collection period	18	8	11	20
Days from raw mat to coll	36	17	20	38
Payables deferral period	127	149	162	150
Cash conversion cycle	(91)	(131)	(142)	(113)
<b>Profitability ratios (%)</b>				
Gross profit margin	39.8	35.4	35.0	35.0
EBIT margin	12.7	11.1	10.0	11.0
EBIT return on avg assets	6.1	5.6	5.2	6.0
Return on average assets	10.0	3.7	8.0	9.3
<b>Financial risk (x)</b>				
Liabilities-to-assets (%)	35.9	36.2	33.7	32.3
Debt-to-equity	0.2	0.4	0.1	0.1
Net debt-to-equity	(0.4)	(0.8)	(0.3)	(0.3)
Times-interest-earned	31.1	21.7	24.2	28.3
Effective interest rate (%)	3.3	3.4	3.2	3.2

★ Alibaba is net cash giving it the ability to continue expanding its ecosystem

# Stock Picking Checklist

*Can this company be a ten bagger?*



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Ratios

Value

Risks

## Checklist

1. **Management** is committed to growth

2. **Growth** can hit double-digits

3. Gross **Margin** can remain high

4. **Earnings** are predictable

5. **Efficient** at deploying assets

6. **Cash Conversion** cycle is low

7. **Cash Flow** is consistently positive

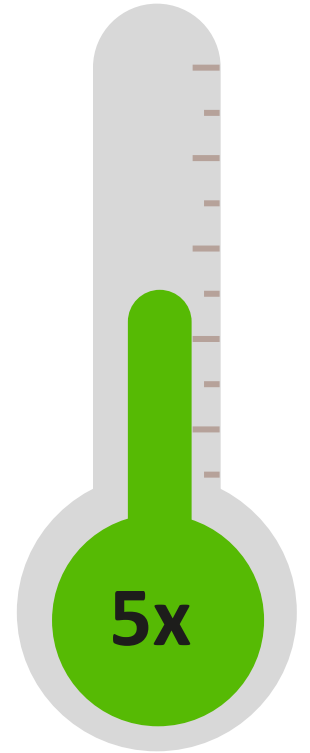
8. **Capital** is readily available

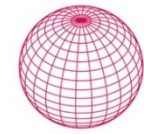
9. **Valuation** is reasonable

Potential

Comment

10x Bagger Potential





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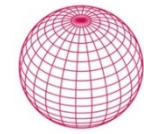
Value

WCB

Risks

<b>(YE Mar, RMB m)</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>
EBIT	91,366.0	94,779.0	92,130.7	115,531.9
<i>Est tax rate (%)</i>	<i>17.7</i>	<i>45.0</i>	<i>16.0</i>	<i>16.0</i>
<b>NOPAT</b>	<b>75,210.4</b>	<b>52,100.6</b>	<b>77,389.8</b>	<b>97,046.8</b>
Add: Depre & amort	47,909.0	11,647.0	24,282.0	33,237.1
<b>Less: CAPEX</b>	<b>(41,450.0)</b>	<b>(37,841.0)</b>	<b>(37,802.3)</b>	<b>(46,113.0)</b>
Chg in A/R	(7,761.0)	39,560.0	(53,742.9)	(7,524.0)
Chg in inventory	(12,999.0)	27,858.0	(31,605.9)	(4,424.8)
Chg in oth curr assets	(39,447.0)	(90,953.0)	45,254.0	(19,347.4)
Chg in A/P	63,110.0	87,404.0	(5,304.7)	37,261.7
Chg in oth curr liabs	64,093.0	(76,382.0)	(11,352.3)	(8,107.5)
<b>Less: Chg in working cap</b>	<b>66,996.0</b>	<b>(12,513.0)</b>	<b>(56,751.9)</b>	<b>(2,142.0)</b>
Less: Chg in invest cap				
<b>Free cash flow to firm</b>	<b>148,665.4</b>	<b>13,393.6</b>	<b>7,117.6</b>	<b>82,028.9</b>

- ★ Alibaba is still pursuing growth, I expect increasing level of CAPEX



Sales

Story

FVMR

Value

WCB

Risks

## Forecast assumptions

<b>3-year average</b>	<b>Consensus</b>	<b>My assumptions</b>
Revenue growth (CAGR)	10.2	12.0
Gross margin	35.5	35.0
EBIT margin	14.5	11.3
Net margin	15.1	17.3

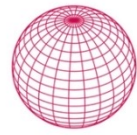
## My valuation method

### Market: Hongkong

Market risk-free rate	1.7
Market equity risk premium	8.0
<b>Market return</b>	<b>9.7</b>
Company beta (x)	1.3
<b>COE</b>	<b>11.7</b>
WACC	11.0
Terminal growth rate	4.0

Valuation Method:  
FCFF

- ★ Expect higher revenue growth than consensus but slightly lower gross margin
- ★ The terminal growth rate is put at 4% due to Alibaba still having a long growth runway



Sales

Story

FVMR

WCB

Ratios

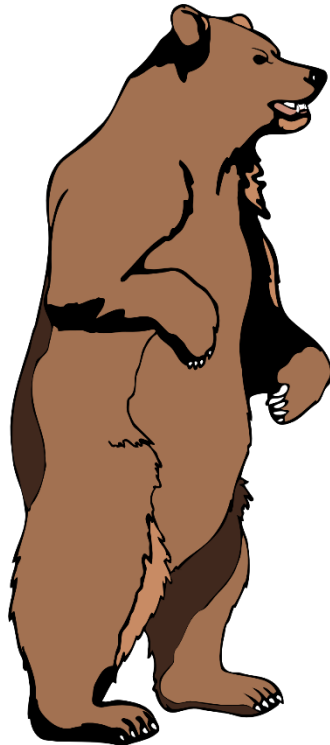
**Value**

Risks

## Bear

### HKD120

(Upside 20%)



## Base

### HKD127

(Upside 27%)



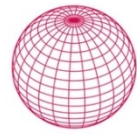
## Bull

### HKD135

(Upside 35%)







Sales

Story

FVMR

Value

WCB

Risks

- ★ Alibaba operates in an increasingly complex legal and regulatory environment
- ★ Failure to build successful ecosystem
- ★ Alliance risks; synergies between subsidiaries might not be successful

# CONCLUSION

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- Direct sales to drive further growth
- Decline in gross margin due to enhanced focus on direct sale
- Dominant position likely to continue despite regulations

