

Alibaba Group (BABA US)

FY1Q17: Abracadabra

BUY

Share Price USD 87.33
 12m Price Target USD 110.00 (+26%)
 Previous Price Target USD 103.00

Reiterate BUY on impressive growth; TP raised 7%

Alibaba has now beaten consensus estimates three quarters in a row. China retail ecommerce revenue grew 49% YoY from 41% in FY4Q16, and outpaced JD's 42% this quarter. Net margin was 5% higher than both street estimate and our forecast. We continue to prefer BABA's superior asset lite model over JD's (JD US, \$23.41; SELL, TP \$21.13). BABA now provides higher revenue growth and significantly better margins.

China retail paves way for revenue growth

China retail business is firing on all cylinders. GMV continued to accelerate to 24.3% YoY from the low of 22.5% in FY3Q16 (4Q15). Mobile monetization surpassed PC for the first time at 2.8%, driven by stronger marketing service revenues and Taobao app improvements. These led to the highest YoY revenue growth since IPO at 49%.

Segment reporting provides more clarity

This is the first quarter Alibaba began to report by segment, and the results are positive. While core commerce business EBITA margin (after depreciation) fell to 61%, mainly due to Lazada consolidation, we believe the surprise came from cloud computing, which demonstrated strong revenue growth at 156% YoY and is almost close to breakeven on an EBITA basis. Digital media/entertainment is still generating sizeable losses, but 286% YoY revenue growth hints at a silver lining.

FY17 profit est. raised;; TP lifted to USD110

We have raised revenue estimates and lowered our operating expenses by 5% and 2% respectively, to incorporate a more robust China ecommerce growth and also to reflect lower costs associated with the consolidated businesses than our previous estimates (see Fig. 5 for est. revisions). We believe Alibaba's strong China retail performances should continue, driven by the company's leverage on the use of Big Data to stimulate incremental consumer spending. As a result, we have raised our SOTP-based TP by 7% to \$110 and reiterate BUY.

FYE Mar (CNY m)	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue	76,204	101,143	157,337	202,468	249,113
EBITDA	27,550	35,732	54,558	67,410	93,651
Core net profit	34,981	42,741	61,126	73,791	99,275
Core FDEPS (CNY)	13.99	16.68	23.62	28.23	37.61
Core FDEPS growth(%)	15.4	19.2	41.6	19.5	33.2
Net DPS (CNY)	0.00	0.00	0.00	0.00	0.00
Core FD P/E (x)	41.5	34.8	24.6	20.5	15.4
P/BV (x)	9.3	6.6	5.3	4.3	3.4
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	37.6	23.5	24.7	23.5	24.8
ROAA (%)	19.1	13.8	15.2	15.2	16.9
EV/EBITDA (x)	42.2	34.7	26.2	20.4	13.8
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	33,306	46,645	65,010
MKE vs. Consensus (%)	-	-	20.2	9.5	14.0

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Company Description

Alibaba is the largest ecommerce company in China, with marketplaces in retail and wholesale, as well as cloud computing and other services.

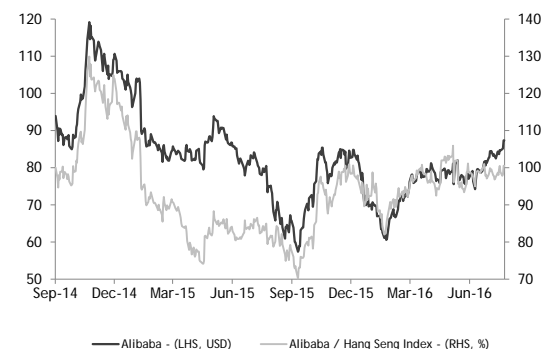
Statistics

52w high/low (USD)	87.33/57.39
3m avg turnover (USDm)	1,193.0
Free float (%)	98.8
Issued shares (m)	2,495
Market capitalisation	USD217.9B
	USD217.9B

Major shareholders:

Temasek Holdings Pte Ltd. (Investment Ma	1.9%
Baillie Gifford & Co.	1.8%
Capital Research & Management Co. (Globa	1.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	7	9	13
Relative to index (%)	(0)	(2)	23

Source: FactSet

1. Investment thesis - BUY

1.1 FY1Q17 results summary of core businesses:

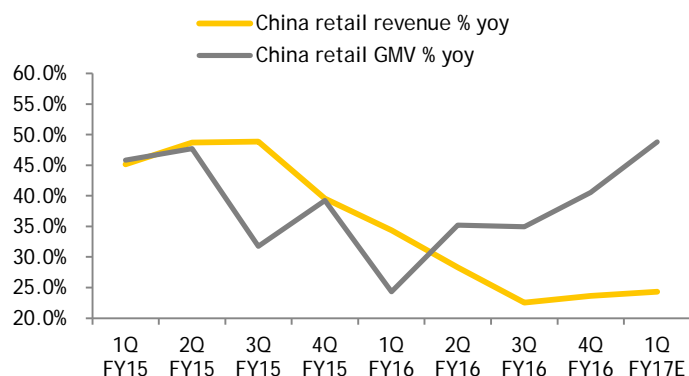
- Total revenue beat our estimates by 6.5% and consensus by 6.8%. YoY growth reaccelerated to 59%, although that includes the consolidation of Lazada and Youku.
- GMV acceleration continued from last quarter, reaching 24.3% YoY. Management said this was driven by more social features injected into the Taobao app. The social connection is not only between buyers and sellers, but among buyers as well. Users open the Taobao app 7 times a day on average. Taobao app had a DAU/MAU ratio of 40% in June.
- China retail mobile monetization surpassed PC for the first time at 2.8%. This led to China retail revenue's jump from 41% YoY last quarter to 49%. The strong retail revenue growth was driven by robust growth of online marketing revenues at 54% YoY. As a result, commission revenue now makes up only 30% of China retail ecommerce revenue.
- GMV settled through Alipay for handsets, FMCG and Tmall supermarket increased by YoY 70%, 67% and 202%, respectively. Tmall Global GMV growth exceeded 130% YoY.
- International retail commerce recorded 123% growth due to consolidation of Lazada, but this led to core commerce EBITDA margin falling 4pps to 61%.
- Cloud computing segment is close to breakeven. EBITA margin level was -13% compared to -76% last year. Paying customers grew to 577k, up 119% YoY. Launched 319 new products and expanded to Japan and Korea during the quarter.
- Revenue from digital media and entertainment, including Youku Tudou, UCWeb and OTT services increased 286% YoY to CNY3.1b. EBITA loss as a % of revenue narrowed by more than half from -67% to -32%.
- Innovation initiatives and others include YunOS, AutoNavi, DingTalk, and others. This segment saw revenue growth of 30%, but EBITA margin deteriorated from -151% to -166%.
- GAAP operating margin was 5.6% higher than expected. Core commerce EBITA margin recorded 61%.
- SBC as a % of revenue decreased from 20% last year to 11% this quarter.
- Shares repurchased in the quarter were 27m shares for US\$2b.

1.2 Summary of associates and investments:

- Koubei generated RMB31m in payment volume at 48% QoQ, while losses narrowed from CNY762m to 245m.
- Cainiao losses widened. The platform delivered an average of 42m packages per day enabled by 1.7m delivery and warehouse personnel, as well as 180k affiliated delivery stations.
- Ant financial profit turned back to positive in the quarter.

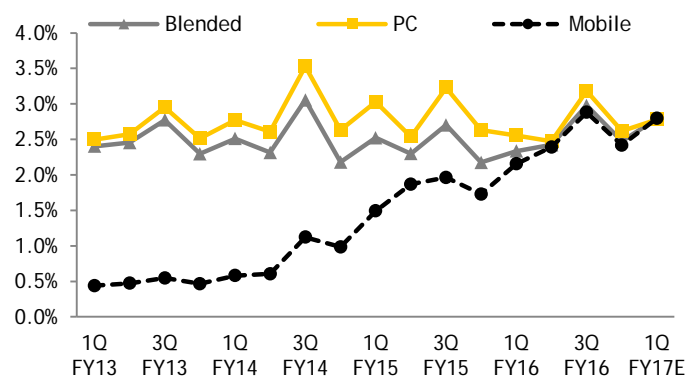
2. Results at a glance

Fig 1: China retail GMV and revenue growth have continued to accelerate since FY4Q16



Source: Company data, Maybank Kim Eng

Fig 2: China retail monetization rate continues to rise; mobile monetization surpassed PC for the first time



Source: Company data, Maybank Kim Eng

Fig 3: Alibaba's FY1Q17 results review

(CNY m)	FY1Q16	FY4Q16	FY1Q17	YoY	QoQ	vs MKE	vs Consensus
Total GMV	673,198	741,937	837,000	24.3%	12.8%	2.2%	
Monetization rate	2.33%	2.47%	2.79%	0.46%	0.32%	0.20%	
Total Revenue	20,245	24,184	32,154	58.8%	33.0%	6.5%	6.8%
Gross Profit, GAAP	13,534	14,622	20,410	50.8%	39.6%	10.5%	9.0%
Gross Margin, GAAP	66.9%	60.5%	63.5%	(3.4%)	3.0%	2.3%	1.3%
Operating Profit, GAAP	5,161	5,112	8,814	70.8%	72.4%	34.0%	34.0%
Operating Margin, GAAP	25.5%	21.1%	27.4%	1.9%	6.3%	5.6%	5.6%
Net Profit, GAAP	30,843	5,365	7,550	(75.5%)	40.7%	36.4%	35.6%
Net Margin, GAAP	152.3%	22.2%	23.5%	(128.9%)	1.3%	5.1%	5.0%
Net Profit, Non-GAAP	9,496	7,635	12,187	28.3%	59.6%	35.0%	13.6%
Net Margin, Non-GAAP	46.9%	31.6%	37.9%	(9.0%)	6.3%	8.0%	2.3%
EPS, GAAP	11.92	2.11	2.94	(75.3%)	39.5%	36.2%	23.6%
EPS, Adjusted	3.68	3.02	4.90	33.3%	62.5%	39.8%	18.1%
Annual active buyers (m)	367	423	434	18.3%	2.6%	(1.5%)	

Source: Company data, Maybank Kim Eng

Fig 4: Segment EBITA overview

(CNY m)	FY1Q16		FY1Q17		YoY	
	EBITA	EBITA Margin	EBITA	EBITA Margin	EBITA	EBITA Margin
Core commerce	12,023	65%	16,624	61%	38%	(4%)
Cloud computing	(368)	(76%)	(158)	(13%)	(57%)	63%
Digital media and entertainment	(543)	(67%)	(996)	(32%)	83%	35%
Innovation initiatives and others	(620)	(151%)	(887)	(166%)	43%	(15%)
Unallocated	(689)		(824)		20%	
Total	9,803	48%	13,759	43%	40%	(5%)

Source: Company data, Maybank Kim Eng

3. Estimate changes and valuation

3.1 Estimate changes

We have raised revenue estimates and lowered our operating expenses by 5% and 2% respectively, as we received more transparency on the consolidated businesses. We believe Alibaba's strong China retail performances should continue, driven by continuous improvement of monetization and GMV growth. On the other hand, we are lowering our cost estimates as we previously overestimated the impact of business consolidation (Lazada, Youku Tudou) on operating expenses, including marketing and G&A. Our target price rose by 7% after incorporating all the changes.

Fig 5: Estimate changes

(CNY m)	Old			New			Change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Total GMV	3,763	4,305	4,745	3,835	4,387	4,837	2%	2%	2%
Total Revenue	150,425	196,232	243,034	157,337	202,468	249,113	5%	3%	3%
Gross Profit, GAAP	97,554	128,630	161,193	102,175	132,791	165,254	5%	3%	3%
Gross Profit, non-GAAP	103,544	134,979	167,242	106,875	137,830	170,835	3%	2%	2%
Operating Profit, GAAP	39,615	54,656	78,074	48,288	58,819	82,580	22%	8%	6%
Operating Profit, non-GAAP	63,683	80,166	102,378	67,168	79,066	105,000	5%	(1%)	3%
EBITDA, GAAP	45,806	63,105	88,951	54,558	67,410	93,651	19%	7%	5%
EBITDA, non-GAAP	70,375	89,143	113,785	73,939	88,185	116,602	5%	(1%)	2%
Net Profit	37,397	52,250	75,243	40,019	51,067	74,108	7%	(2%)	(2%)
Net Profit, non-GAAP	51,692	68,237	90,294	61,126	73,791	99,275	18%	8%	10%

Source: Maybank Kim Eng

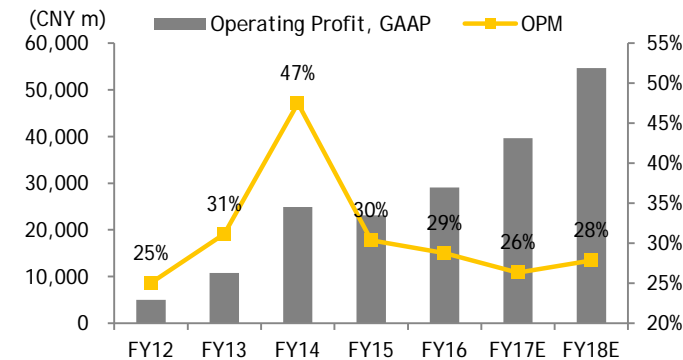
3.2 Valuation

Our price target of USD110 is based on a sum of the part analysis. We used a DCF valuation methodology for the core eCommerce business, as we believe DCF is the best methodology for capturing the long-term value of the platform. We are using a WACC of 8.8%, a cost of equity of 10.1%, and a terminal growth rate of 3%. We also added the NAV (Net Asset Value) of the associates at the initial investment value. There is more upside if some or all of these associates' equity values rise in the future.

Value Proposition

- Dominant e-commerce company in China well positioned to capture the strong consumption growth and the rise of SMEs.
- Its dominant scale and asset-lite business model allow the company to enjoy sustainable long-term growth and broadly maintain market leadership.
- Estimated to generate a FCF yield of 10-15% in the outer years thanks to its high margins and low capex requirement.
- The company is investing significantly in future businesses to broaden its platform. Unlocking the value of such assets could provide further upside.

Operating profit forecast

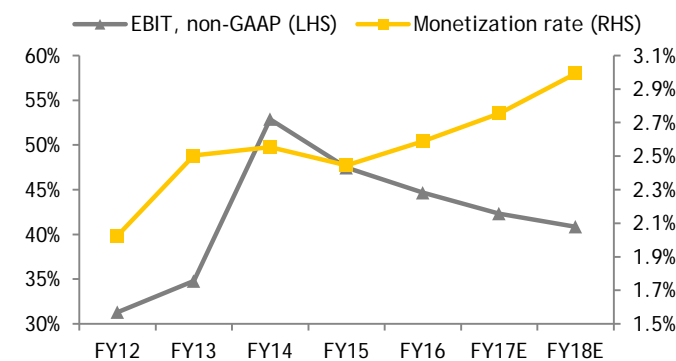


Source: Company data, Maybank Kim Eng

Financial Metrics

- To assess revenue growth, investors need to focus on GMV (gross sales) and monetization rate.
- Monetization rate shows how much revenue is generated from sales transacted on the platforms.
- Operating margin: any sign of margin increase with costs containment could be a catalyst for the stock.
- ROA in the long term to improve from 13.8% in FY16A to 16.9% by FY19e.

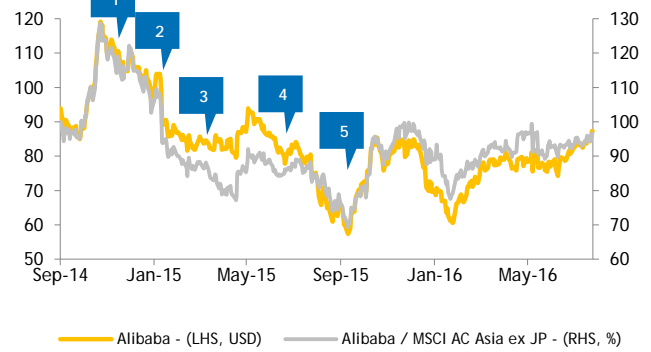
Operating margin and blended monetization rate



Source: Company data, Maybank Kim Eng

Price Drivers

Historical share price trend



Source: Company data, Maybank Kim Eng

1. Post-IPO, investors took some chips off the table, selling into stronger than expected 3Q15 results.
2. Concerns over allegation of Taobao selling counterfeit goods created an overhang, as well as a continuing decline of its monetization rate.
3. Solid GMV growth at JD prompted investors to switch to JD on concern that JD wins market share from Alibaba, like Amazon did over eBay. BABA shares completely ignored throughout China liquidity run.
4. Weak revenue growth in 2Q15 (1QFY16) led market concerns.
5. BABA outperformed the rebounding market as 3Q15 monetization rate grew YoY for the first time since 2Q14.

Swing Factors

Upside

- Better than expected monetization rate (PC to stabilize quicker / mobile monetization to improve).
- Higher margins, as associates improve their margins.
- Listing of key associates or assets in 2016 (e.g., Alipay and Didi Kaudi).

Downside

- Loss of major global brand to JD.com due to counterfeit concerns and/or unexpected regulatory changes proposed by the government.
- Slower buyer growth or decline in GMV per buyer as competition intensifies or monetization rate declines.
- Losses from new investments and associates drag down margins.

FYE 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Key Metrics					
P/E (reported) (x)	55.7	20.0	37.1	29.4	20.5
Core P/E (x)	38.8	33.4	24.3	20.3	15.3
Core FD P/E (x)	41.5	34.8	24.6	20.5	15.4
P/BV (x)	9.3	6.6	5.3	4.3	3.4
P/NTA (x)	9.3	6.6	5.3	4.3	3.4
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	2.5	3.2	4.1	4.8	6.4
EV/EBITDA (x)	42.2	34.7	26.2	20.4	13.8
EV/EBIT (x)	50.2	42.6	29.6	23.4	15.6

INCOME STATEMENT (CNY m)

Revenue	76,204.0	101,143.0	157,337.2	202,467.9	249,113.2
Gross profit	52,370.0	66,788.0	102,175.5	132,790.7	165,254.1
EBITDA	27,550.0	35,732.0	54,558.4	67,410.2	93,650.8
Depreciation	(2,326.0)	(3,699.0)	(4,813.9)	(6,912.2)	(9,125.2)
Amortisation	(2,089.0)	(2,931.0)	(1,456.6)	(1,678.8)	(1,945.5)
EBIT	23,135.0	29,102.0	48,287.9	58,819.2	82,580.2
Net interest income / (exp)	6,705.0	50,308.0	5,320.0	8,403.3	13,237.9
Associates & JV	(1,590.0)	(1,730.0)	(6,000.0)	(6,000.0)	(6,000.0)
Other pretax income	2,486.0	2,058.0	3,915.5	4,111.2	4,316.8
Pretax profit	30,736.0	79,738.0	51,523.3	65,333.6	94,134.9
Income tax	(6,416.0)	(8,449.0)	(11,504.7)	(14,266.7)	(20,027.0)
Reported net profit	24,320.0	71,289.0	40,018.7	51,066.9	74,107.9
Core net profit	34,981.0	42,741.0	61,126.3	73,790.5	99,274.9

BALANCE SHEET (CNY m)

Cash & Short Term Investments	108,193.0	106,818.0	144,109.2	209,592.5	305,264.7
Accounts receivable	13,813.0	17,028.0	27,978.4	36,628.4	42,378.2
Inventory	0.0	0.0	0.0	0.0	0.0
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	9,139.0	13,629.0	19,519.1	26,779.7	32,601.3
Intangible assets	48,508.0	87,015.0	107,734.4	113,836.4	115,243.4
Investment in Associates & JVs	33,877.0	91,461.0	91,461.0	91,461.0	91,461.0
Other assets	41,904.0	48,499.0	50,886.1	53,549.4	55,310.9
Total assets	255,434.0	364,450.0	441,688.3	531,847.3	642,259.5
ST interest bearing debt	1,990.0	4,304.0	637.0	471.0	215.0
Accounts payable	19,834.0	27,334.0	40,756.1	53,687.3	62,240.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	50,603.0	53,467.0	53,467.0	53,467.0	53,467.0
Other liabilities	24,936.0	29,456.0	38,040.0	44,120.0	49,708.0
Total Liabilities	97,363.0	114,561.0	132,900.1	151,745.5	165,629.6
Shareholders Equity	146,097.0	217,337.0	277,868.1	350,813.8	448,973.9
Minority Interest	11,974.0	32,552.0	30,920.0	29,288.0	27,656.0
Total shareholder equity	158,071.0	249,889.0	308,788.1	380,101.8	476,629.9
Total liabilities and equity	255,434.0	364,450.0	441,688.3	531,847.3	642,259.5

CASH FLOW (CNY m)

Pretax profit	30,736.0	79,738.0	51,523.3	65,333.6	94,134.9
Depreciation & amortisation	4,415.0	6,630.0	6,270.5	8,591.1	11,070.7
Adj net interest (income)/exp	(6,705.0)	(50,308.0)	(5,320.0)	(8,403.3)	(13,237.9)
Change in working capital	1,854.0	7,792.0	8,479.6	7,557.5	6,514.4
Cash taxes paid	(6,416.0)	(8,449.0)	(11,504.7)	(14,266.7)	(20,027.0)
Other operating cash flow	10,628.0	(28,875.0)	19,570.1	20,915.4	23,065.9
Cash flow from operations	34,512.0	6,528.0	69,018.8	79,727.6	101,520.9
Capex	(7,705.0)	(10,845.0)	(13,091.4)	(16,394.8)	(17,613.3)
Free cash flow	33,512.0	45,991.0	61,247.4	71,736.0	97,145.5
Equity raised / (purchased)	61,438.0	(19,102.0)	0.0	0.0	0.0
Change in Debt	25,940.0	2,478.0	(3,667.0)	(166.0)	(256.0)
Perpetual securities distribution	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	(38,925.0)	18,375.0	(14,969.2)	2,316.5	12,020.6
Effect of exch rate changes	(112.0)	466.0	0.0	0.0	0.0
Net cash flow	75,148.0	(2,100.0)	37,291.2	65,483.2	95,672.2

FYE 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Key Ratios					
Growth ratios (%)					
Revenue growth	45.1	32.7	55.6	28.7	23.0
EBITDA growth	3.7	29.7	52.7	23.6	38.9
EBIT growth	(7.2)	25.8	65.9	21.8	40.4
Pretax growth	15.6	159.4	(35.4)	26.8	44.1
Reported net profit growth	3.9	193.1	(43.9)	27.6	45.1
Core net profit growth	23.7	22.2	43.0	20.7	34.5
Profitability ratios (%)					
EBITDA margin	36.2	35.3	34.7	33.3	37.6
EBIT margin	30.4	28.8	30.7	29.1	33.1
Pretax profit margin	40.3	78.8	32.7	32.3	37.8
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	31.9	70.5	25.4	25.2	29.7
Revenue/Assets (x)	0.3	0.3	0.4	0.4	0.4
Assets/Equity (x)	1.7	1.7	1.6	1.5	1.4
ROAE (%)	37.6	23.5	24.7	23.5	24.8
ROAA (%)	19.1	13.8	15.2	15.2	16.9
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	74.8	54.9	51.5	57.4	57.1
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	239.6	247.1	222.2	244.0	248.8
Dividend cover (x)	nm	nm	nm	nm	nm
Current ratio (x)	3.6	2.6	2.7	3.0	3.7
Leverage & Expense Analysis					
Asset/Liability (x)	2.6	3.2	3.3	3.5	3.9
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	1.9	1.6	1.0	0.8	0.6
Capex/revenue (%)	10.1	10.7	8.3	8.1	7.1
Net debt/ (net cash)	(55,600.0)	(49,047.0)	(90,005.2)	(155,654.5)	(251,582.7)

Source: Company; Maybank

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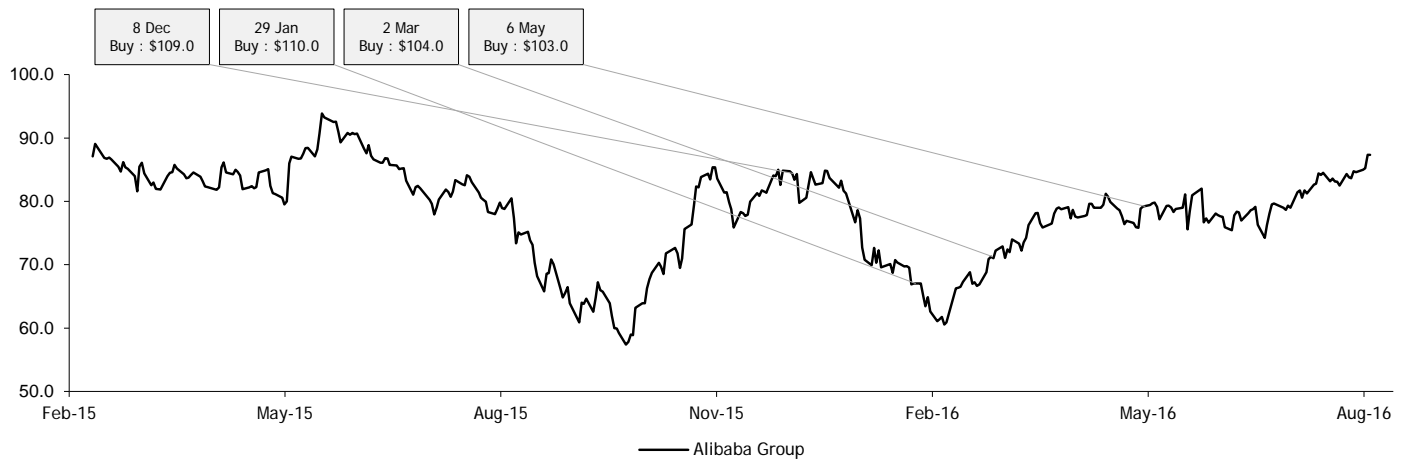
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