

Alibaba Group (BABA US)

Going for another ride

Raising target price by 18%, reiterating BUY

BABA shares are up 33% YTD, but we believe there is still more upside to this premier e-commerce platform given the potential for the company to monetize its traffic through higher take rates in the form of higher P4P (Pay for Performance) rates and volume. We raised our above-consensus earnings forecasts by 3% to 9% for FY17 to FY19. In addition, we now incorporate the 33% notional value of Ant Financial based on the reported last round of private equity funding of USD60b.

Paid placement ads raising monetization rate

The beauty of Alibaba's pure platform model is its revenue growth is less dependent on transaction growth or listing commission fees. This is unlike the traditional platform models such as eBay and JD.com. At the same time, BABA's blended monetization rate is still much lower than eBay or JD.com's, which implies greater upside. We raised our monetization rate assumption for FY20 to 4.0% from 3.5% as we believe the powerful Big Data enabled personalize shopping experience and continuing increase in traffic on both TaoBao and Tmall platforms will allow the monetization rate to rise beyond our previous forecast.

Inclusion of Ant Financial adds USD10 per share

Ant Financial has gone through two rounds of private equity financing with the last valuation reaching USD60b. We believe it would be unreasonable at this time to ignore this value. This adds about 9% to our equity value for BABA.

Risk to our call: margin drag from new businesses

BABA's overall margins are likely to come under pressure as its new loss-making businesses, including Youku and Lazada, are reported on a consolidated basis. Losses from these subsidiaries are likely to widen, and hence become a drag on margins. While core business margins are on an upward track, a more significant seasonal volatility could lead to larger fluctuations in margins.

FYE Mar (CNY m)	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue	76,204	101,143	161,382	215,783	265,847
EBITDA	27,550	35,732	56,459	73,802	101,884
Core net profit	34,981	42,741	63,154	80,384	107,778
Core FDEPS (CNY)	13.99	16.68	24.41	30.76	40.83
Core FDEPS growth(%)	15.4	19.2	46.3	26.0	32.8
Net DPS (CNY)	0.00	0.00	0.00	0.00	0.00
Core FD P/E (x)	52.1	43.7	29.9	23.7	17.9
P/BV (x)	11.7	8.2	6.7	5.3	4.1
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	26.2	39.2	16.7	17.6	19.6
ROAA (%)	19.1	13.8	15.6	16.2	17.8
EV/EBITDA (x)	42.2	34.7	32.0	23.7	16.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	34,628	47,801	68,489
MKE vs. Consensus (%)	-	-	20.0	17.8	18.4

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BUY

Share Price	USD 109.36
12m Price Target	USD 130.00 (+19%)
Previous Price Target	USD 110.00

Company Description

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

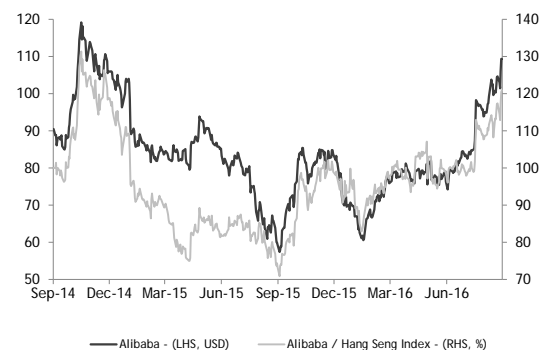
Statistics

52w high/low (USD)	109.36/57.39
3m avg turnover (USDm)	1,484.4
Free float (%)	99.1
Issued shares (m)	2,495
Market capitalisation	USD272.9B
	USD272.9B

Major shareholders:

Temasek Holdings Pte Ltd. (Investment Ma	2.2%
Baillie Gifford & Co.	1.8%
Capital Research & Management Co. (Globa	1.4%

Price Performance



	-1M	-3M	-12M
Absolute (%)	14	38	82
Relative to index (%)	11	22	64

Source: FactSet

Name	Ticker	Rating	TP (USD)
Alibaba	BABA US	Buy	130.00
JD.com	JD US	Sell	21.13
eBay	EBAY US	Not Rated	n/a
Amazon	AMZN US	Not Rated	n/a

1. Investment thesis - BUY; Target price raised

1.1 Going with a more robust monetization rate scenario

We have raised our target price for BABA by 18% to USD130 as we have a more bullish monetization rate assumption and have included Ant Financial's value for the first time.

We are using a more bullish monetization rate assumption as we believe Alibaba's positive operating trends will allow the company to monetize more from the transactions. According to the company, it is seeing: 1) higher average spending on advertisement by brands and merchants using Alibaba's marketing services; and 2) the positive impact of incremental additions of online marketing inventory. In addition, based on our analysis, Tmall's average commission rate is rising. We are now forecasting the blended monetization rate to reach 4.0% by FY20 (March ending 2020), up from our previous assumption of 3.5%.

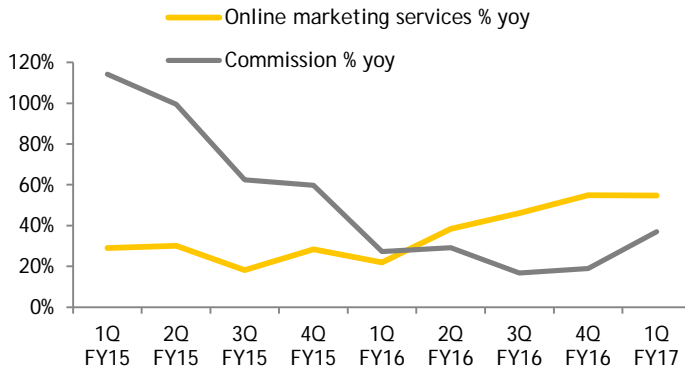
Pending regulatory approval, Alibaba will be able to opt to take a 33% stake in Ant Financial in the event the financial arm successfully conducts an IPO. While there is no time table for the IPO yet, considering the multiple rounds of private equity financing conducted over the past 18 months, we believe there is a reasonable probability of such event in the near future. For this reason, we are now using the last known financing round valuation of USD60b to arrive at a USD10 per BABA share value for the stake.

1.2 More than just a platform

Back in Jun-16 at Alibaba's Investor Day, we were impressed with how Alibaba was redefining its platform from just a "dumb" transaction medium to a sophisticated engagement platform. It is now providing its sellers the tools for brand building, customer acquisition and engagement, as well as smart product launch planning and inventory management, while taking shopping experience to another level through personalized webpages and product recommendations as well as targeted promotions. We believe these efforts are already starting to and will continue to manifest into higher numbers (both GMV and monetization rate).

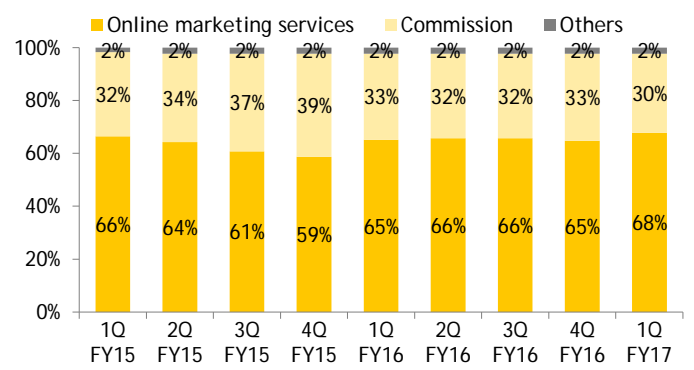
Taobao app users are demonstrating higher user engagement per day (30 min on average) as Alibaba continuously improves the application. Online marketing services revenue portion grew 55% YoY in the past two quarters, according to our estimates, and is now making up 68% of Alibaba's China retail commerce revenue, compared to 65% in the previous quarter. Growth of this segment is outpacing the growth of commission, which is more closely related to Alibaba's GMV. Online marketing inventories added last year are also finally in full effects and are driving marketing revenue growth.

Fig 1: Online marketing services revenue YoY growth is outpacing commission (which is more related to GMV)...



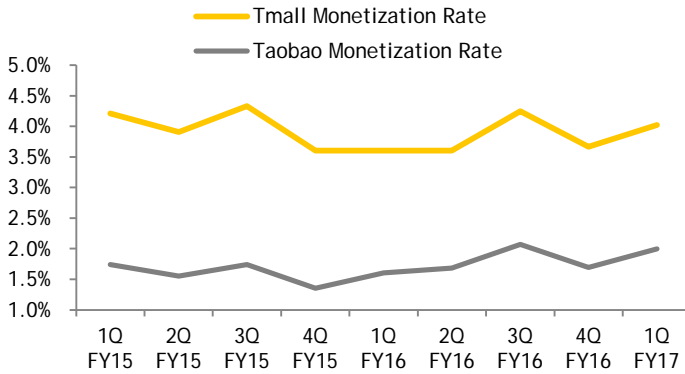
Source: Company data, Maybank Kim Eng

Fig 2: ...and it now makes up 68% of China retail commerce revenue



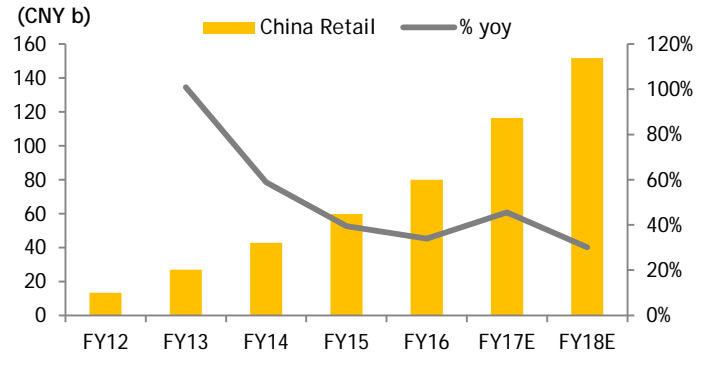
Source: Company data, Maybank Kim Eng

Fig 3: We estimate Taobao's monetization rate is accelerating...



Source: Maybank Kim Eng

Fig 4: ... and will be a key driver to China retail commerce revenue



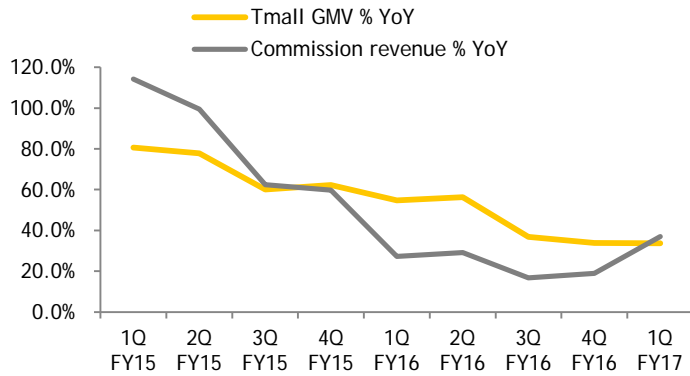
Source: Company data, Maybank Kim Eng

1.3 Commission rate on the rise

Alibaba's commission revenue makes up 30% of China retail commerce revenue. The majority of the commission revenue is generated by Tmall and a smaller contribution comes from the daily deal site, Juhuasuan, in our view. Tmall's GMV grew 34% YoY while commission revenue rose 37%, implying that commission rates are on the rise (the company does not disclose Juhuasuan's revenue). This is one of the reasons why the monetization rate is on the rise, in our view. The result is positive because we forecast Tmall to overtake Taobao as the largest contributor to China retail commerce GMV by FY18, and only Tmall charges a commission.

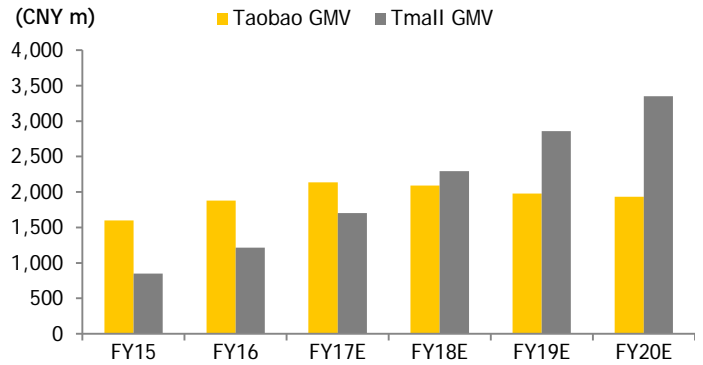
Tmall's proportion of total GMV peaked at 41.6% in FY3Q16 (CY4Q15) and slid a bit to 39.3% in FY1Q17. This has been a seasonal trend, and we estimate Tmall's GMV to make up 44% of the total GMV for FY17.

Fig 5: Commission % YoY growth is outpacing Tmall's GMV growth, implying that Alibaba is able to charge higher commission rates



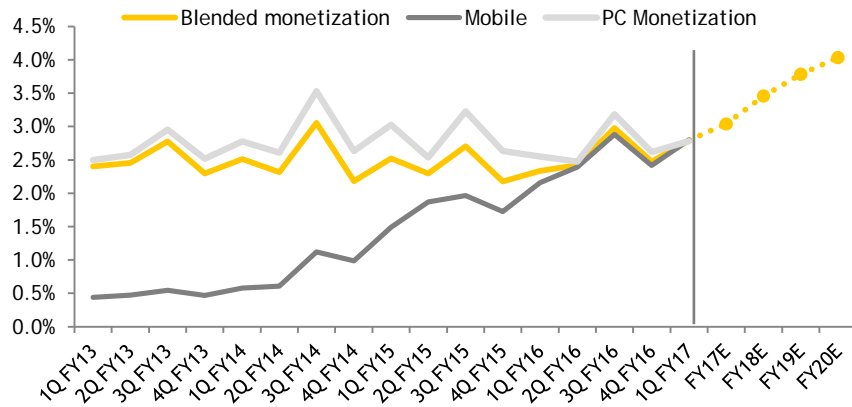
Source: Company data, Maybank Kim Eng

Fig 6: Tmall to overtake Taobao as the largest contributor to China retail commerce GMV; positive for Alibaba because only Tmall charges a commission



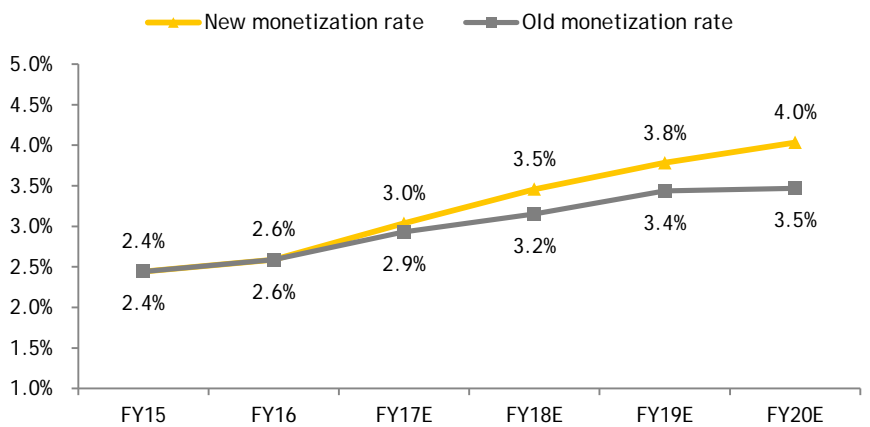
Source: Company data, Maybank Kim Eng

Fig 7: We forecast blended monetization rate to reach PC monetization rate's last peak at 3.5% by FY18



Source: Company data, Maybank Kim Eng

Fig 8: We have increased monetization rate assumptions to reflect our view

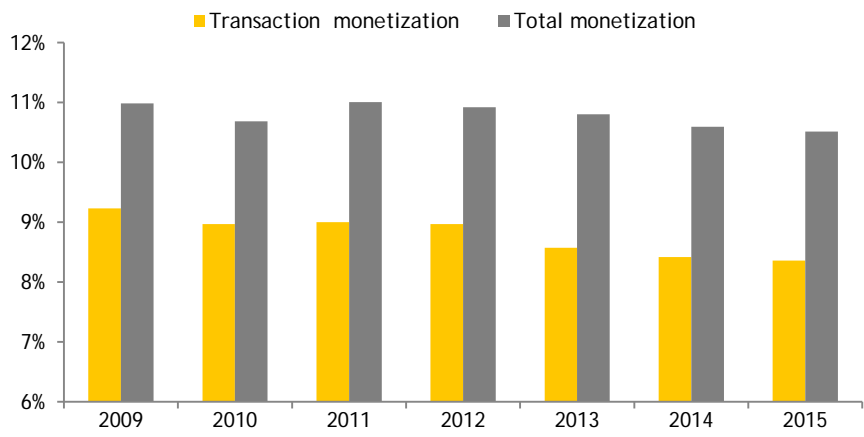


Source: Company data, Maybank Kim Eng

1.4 Compared with other platforms

The beauty of Alibaba’s pure platform model is its revenue growth is less dependent on transaction growth or listing commission fees. This is unlike the traditional platform models such as eBay and party JD.com. For example, eBay’s revenue generation model relies heavily on transaction revenue as it charges various fees to customers. While that model has provided eBay with a high take rate since inception (10-11%), blended take rate (monetization rate) is on a declining trend. The transaction fees limited the company’s ability to generate higher advertising fees.

Fig 9: eBay’s monetization rate



Source: Company data, Maybank Kim Eng

1.5 Ant Financial financing highlight

Fig 10: Ant Financial’s historical funding and valuation

(USD b)	Series A	Series B
Fund raised	n/a	4.5
Valuation	45.0	60.0

Source: Maybank Kim Eng

2. Estimate changes

We have adjusted our monetization rate (Fig 8) to reflect our latest views on China retail commerce revenue and total revenue of Alibaba. In addition, we have also included Ant Financial's valuation after the company's second round of private fund raising. We adopted the latest Series B valuation of USD60b in our model to reflect this. This adds 9% to our Alibaba equity value. Combined with valuation changes of other associates, total associates changes added USD7 to our equity value on a net basis.

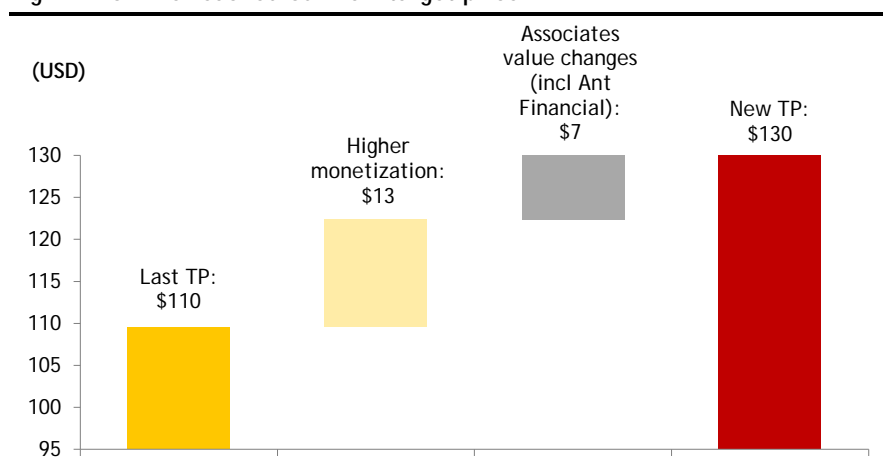
Fig 11: Forecast changes

(CNY m)	Old			New			Change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Total GMV	3,835	4,387	4,837	3,835	4,387	4,837	0%	0%	0%
Total Revenue	157,337	202,468	249,113	161,382	215,783	265,847	3%	7%	7%
Gross Profit, GAAP	102,175	132,791	165,254	104,880	141,795	176,637	3%	7%	7%
Gross Profit, non-GAAP	106,875	137,830	170,835	109,700	147,166	182,593	3%	7%	7%
Operating Profit, GAAP	48,288	58,819	82,580	50,143	65,027	90,483	4%	11%	10%
Operating Profit, non-GAAP	67,168	79,066	105,000	69,509	86,606	114,409	3%	10%	9%
EBITDA, GAAP	54,558	67,410	93,651	56,459	73,802	101,884	3%	9%	9%
EBITDA, non-GAAP	73,939	88,185	116,602	76,326	95,908	126,342	3%	9%	8%
Net Profit	40,019	51,067	74,108	41,561	56,329	81,105	4%	10%	9%
Net Profit, non-GAAP	61,126	73,791	99,275	63,154	80,384	107,778	3%	9%	9%

Source: Maybank Kim Eng

Our TP of USD130 is based on a sum-of-the-parts analysis. We used a DCF valuation methodology for the core e-commerce 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 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.

Fig 12: How we reached our new target price

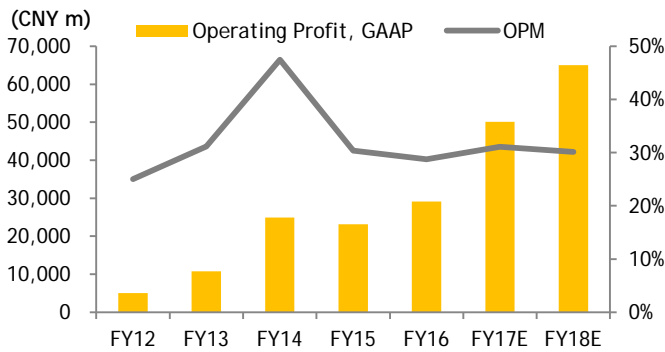


Source: Maybank Kim Eng

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.

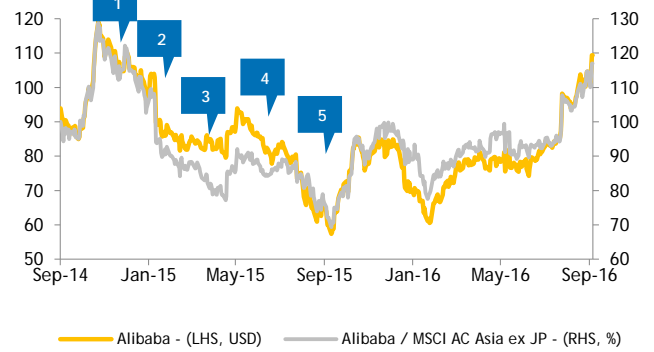
Operating profit forecast



Source: Company data, Maybank Kim Eng

Price Drivers

Historical share price trend



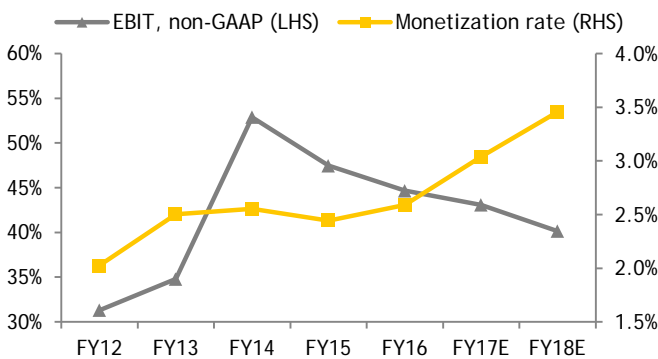
Source: Company data, Maybank Kim Eng

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.

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

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)	70.1	25.2	45.0	33.5	23.5
Core P/E (x)	48.7	41.9	29.6	23.5	17.7
Core FD P/E (x)	52.1	43.7	29.9	23.7	17.9
P/BV (x)	11.7	8.2	6.7	5.3	4.1
P/NTA (x)	11.7	8.2	6.7	5.3	4.1
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	2.0	2.6	3.4	4.2	5.5
EV/EBITDA (x)	42.2	34.7	32.0	23.7	16.3
EV/EBIT (x)	50.2	42.6	36.0	26.9	18.4

INCOME STATEMENT (CNY m)

Revenue	76,204.0	101,143.0	161,381.7	215,783.1	265,847.4
Gross profit	52,370.0	66,788.0	104,879.7	141,795.0	176,637.2
EBITDA	27,550.0	35,732.0	56,459.3	73,801.5	101,884.1
Depreciation	(2,326.0)	(3,699.0)	(4,859.9)	(7,095.3)	(9,456.0)
Amortisation	(2,089.0)	(2,931.0)	(1,456.6)	(1,678.8)	(1,945.5)
EBIT	23,135.0	29,102.0	50,142.8	65,027.3	90,482.6
Net interest income / (exp)	6,705.0	50,308.0	5,393.2	8,772.2	14,081.5
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	53,451.5	71,910.8	102,880.8
Income tax	(6,416.0)	(8,449.0)	(11,890.3)	(15,582.2)	(21,776.2)
Reported net profit	24,320.0	71,289.0	41,561.2	56,328.6	81,104.7
Core net profit	34,981.0	42,741.0	63,154.2	80,383.8	107,777.8
Preferred Dividends	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET (CNY m)

Cash & Short Term Investments	108,193.0	106,818.0	146,550.1	219,451.2	323,525.1
Accounts receivable	13,813.0	17,028.0	28,513.9	38,366.4	44,538.1
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	19,796.7	27,806.2	34,301.0
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	51,054.6	54,096.5	55,990.8
Total assets	255,434.0	364,450.0	445,110.7	545,017.7	665,059.4
ST interest bearing debt	1,990.0	4,304.0	637.0	471.0	215.0
Accounts payable	19,834.0	27,334.0	41,574.4	56,343.4	65,540.8
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	38,616.0	46,013.0	52,083.0
Total Liabilities	97,363.0	114,561.0	134,294.7	156,294.7	171,305.5
Shareholders Equity	146,097.0	217,337.0	279,896.0	359,435.0	466,097.9
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	310,816.0	388,723.0	493,753.9
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	255,434.0	364,450.0	445,110.7	545,017.7	665,059.4

CASH FLOW (CNY m)

Pretax profit	30,736.0	79,738.0	53,451.5	71,910.8	102,880.8
Depreciation & amortisation	4,415.0	6,630.0	6,316.5	8,774.2	11,401.5
Adj net interest (income)/exp	(6,705.0)	(50,308.0)	(5,393.2)	(8,772.2)	(14,081.5)
Change in working capital	1,854.0	7,792.0	9,170.2	9,131.1	7,086.5
Cash taxes paid	(6,416.0)	(8,449.0)	(11,890.3)	(15,582.2)	(21,776.2)
Other operating cash flow	10,628.0	(28,875.0)	20,055.4	22,246.9	24,572.0
Cash flow from operations	34,512.0	6,528.0	71,710.0	87,708.5	110,083.1
Capex	(7,705.0)	(10,845.0)	(13,414.9)	(17,326.9)	(18,617.3)
Free cash flow	33,512.0	45,991.0	63,688.3	79,153.8	105,547.3
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	(14,896.0)	2,685.5	12,864.1
Effect of exch rate changes	(112.0)	466.0	0.0	0.0	0.0
Net cash flow	75,148.0	(2,100.0)	39,732.1	72,901.1	104,073.9

FYE 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Key Ratios					
Growth ratios (%)					
Revenue growth	45.1	32.7	59.6	33.7	23.2
EBITDA growth	3.7	29.7	58.0	30.7	38.1
EBIT growth	(7.2)	25.8	72.3	29.7	39.1
Pretax growth	15.6	159.4	(33.0)	34.5	43.1
Reported net profit growth	3.9	193.1	(41.7)	35.5	44.0
Core net profit growth	23.7	22.2	47.8	27.3	34.1
Profitability ratios (%)					
EBITDA margin	36.2	35.3	35.0	34.2	38.3
EBIT margin	30.4	28.8	31.1	30.1	34.0
Pretax profit margin	40.3	78.8	33.1	33.3	38.7
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	31.9	70.5	25.8	26.1	30.5
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 (%)	26.2	39.2	16.7	17.6	19.6
ROAA (%)	19.1	13.8	15.6	16.2	17.8
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	74.8	54.9	50.8	55.8	56.1
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	239.6	247.1	219.5	238.2	245.9
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 gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	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	0.7	0.5
Capex/revenue (%)	10.1	10.7	8.3	8.0	7.0
Net debt/ (net cash)	(55,600.0)	(49,047.0)	(92,446.1)	(165,513.2)	(269,843.1)

Source: Company; Maybank

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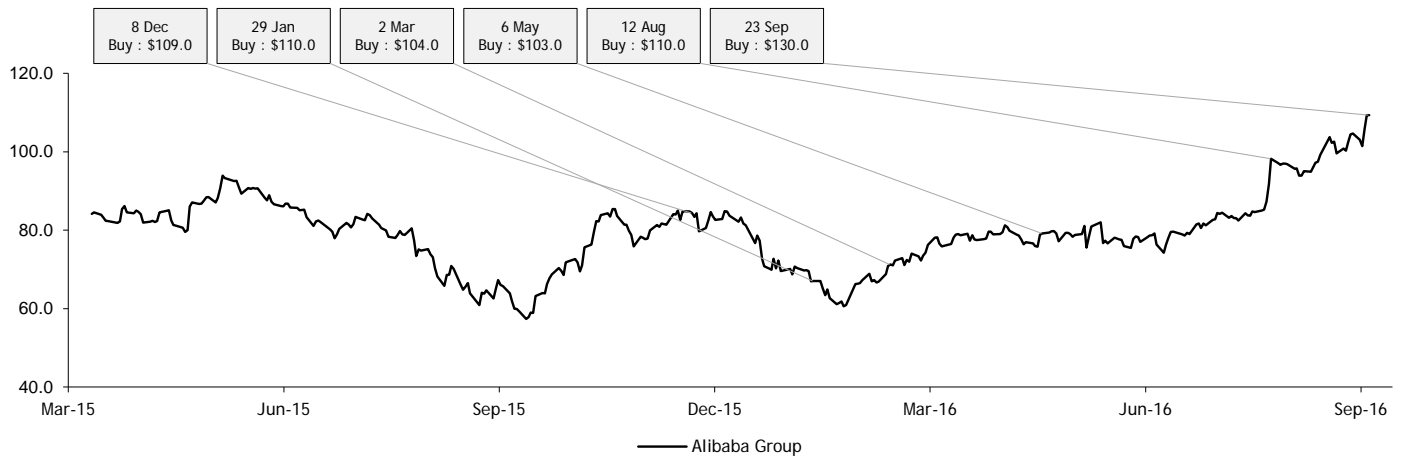
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