



Alibaba (9988 HK/BABA US) Reinvesting for future

- Weaker near-term profitability as the Company plans to use all incremental profits to support merchants and invest in new businesses in FY3/22
- Mixed 1Q21 results with 64% YoY revenue growth and 13% YoY core net profit growth
- Lower TP for Alibaba-SW (9988 HK) and Alibaba-ADR (BABA US) to HK\$ 270 and US\$278

1Q21 highlights. In 1Q21 (4QFY3/21), Alibaba's revenue grew by 64% YoY to RMB 187bn, 4% above market expectation, driven by consolidation of SunArt (6808 HK) and low base. Core net profit grew by 13% YoY to RMB28.3bn, 3% below market expectation. Including RMB 18.2bn anti-trust fine, the Company reported RMB 5.5bn in net losses.

Reinvesting for the future. Looking forward, the Company expects to generate over RMB 930bn in revenue for FY3/22, up 30% YoY. It plans to use all of incremental profits and additional capital in FY3/22 to support merchants and invest in new businesses and key strategic areas. In our view, this aggressive investment plan could slow profit growth in FY3/22E before growth momentum improves in FY3/23E.

Merchant supports and community group purchase. The Company plans to strengthen its support to merchants via providing more value-added technological services to increase loyalty. We view it as a client retention initiative as the merchants may seek to operate on multiple online ecommerce platforms under the new regulatory environment. Community group purchase could be another key investment area as Meituan (3690 HK) and Pinduoduo (PDD US) are ahead in terms of geographical coverage, and Alibaba has only recently launched its Hema community mini app (盒马集市), operating in selected cities and provinces.

Recommendation. We lower our SOTP-based TP for Alibaba-SW (9988 HK) and Alibaba-ADR (BABA US) to HK\$ 270 and US\$ 278 to reflect lower near-term profit growth outlook.

Results and Valuation

FY end Mar 31	FY20A	FY21A	FY22E	FY23E
Revenue (RMB mn)	509,711	717,289	933,445	1,173,857
Chg (% YoY)	35.3	40.7	30.1	25.8
Net profit (RMB mn)	149,263	150,308	190,016	215,462
Chg (% YoY)	70.4	0.7	26.4	13.4
Core net profit (RMB mn)	141,344	178,954	186,279	224,170
Chg (% YoY)	40.3	26.6	4.1	20.3
Underlying EPS (RMB)	7.1	7.0	8.8	10.0
Chg (% YoY)	67.3	(2.1)	26.4	13.4
Core EPS (RMB)*	6.6	8.3	8.6	10.4
Chg (% YoY)	35.0	25.7	4.1	20.3
Core P/E (x)- ADR*	25.4	20.6	19.8	16.4
Core P/E (x)-SW share*	24.7	21.7	20.1	16.7
ROAE (%)	20.2	15.5	16.0	15.1
ROAA (%)	13.1	10.0	10.5	10.2

1 ADR = 8 ordinary shares; HKD/CNY=0.8284

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

Source (s): Bloomberg, ABCI Securities estimates

Company Report

Rating (SW-share): BUY
TP (SW-share): HK\$ 270
Rating (ADR): BUY
TP (ADR): US\$ 278

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Price (ADR/SW-share)	US\$206.0/ HK\$204.6
Est. share price return (ADR/SW-share)	34.9%/32.0%
Est. dividend yield (ADR/SW-share)	NA/NA
Est. total return (ADR/SW-share)	34.9%/32.0%
Last Rating & TP (ADR/SW-share)	BUY, US\$330/ BUY, HK\$320

Previous Report Date Apr 14, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (SW-share)	309.4/190.3
52Wk H/L (US\$) (ADR)	319.3/194.0
Issued shares (mn)	21,645
Market cap (HK\$ mn) (all share)	4,428,567
3-mth avg daily turnover (HK\$ mn) (SW-share)	5,135
3-mth avg daily turnover (US\$ mn) (ADR)	3,700
Major shareholder(s) (%):	
Softbank	25.1%
Jack Ma	6.0%
Joseph Tsai	1.9%

Source(s): Bloomberg, HKEx, Company



In 1Q21 (4QFY3/21) Alibaba's revenue grew by 64% YoY to RMB 187bn, 4% above market expectation, driven by consolidation of SunArt and low base in 1Q20. Core net profit, excluding the anti-trust fine, grew by 13% YoY to RMB 28.3bn, 3% below market expectation. Including the RMB 18.2bn anti-trust fine, net losses were RMB 5.5bn.

By business segment, core commerce revenue, which accounted for 86% of total revenue, grew 72% YoY in 1Q21 vs. the 38% YoY growth in the previous quarter because of the low base in 1Q20 and improved monetization from new valued-added services, such as the recommendation feeds.

Cloud computing revenue grew by 37% YoY in 1Q21, driven by customers in the internet, public sector and finance industries. Having said that, the segment's growth was lower than the 50% YoY growth in the previous quarter as a top customer terminated.

In 1Q21, share of profit from the Ant Group was RMB 5.1bn vs. RMB 4.9bn in the previous quarter, implying a healthy financial status up to 4Q20 (Alibaba reported share of profit from Ant one quarter in arrears) despite delay of IPO and tightened regulations.

Exhibit 1: 1Q21 highlights

Results review:	1Q20	1Q21	YoY%	Remarks
Annual active buyers (mn)	726	811	12%	
Mobile active users (mn)	846	925	9%	
Financials (RMB mn)				
Core commerce	93,865	161,365	72%	Low base
Cloud computing	12,217	16,761	37%	
Digital Media/innovation initiatives	8,232	9,269	13%	
Total revenue	114,314	187,395	64%	4% above market expectation
Cost of sales	(72,502)	(125,454)	73%	
Gross profit	41,812	61,941	48%	
Operating Profits	7,131	(7,663)	NA	
Net profit	3,162	(5,479)	NA	RMB18.2bn antitrust fine
Core net profit	25,100	28,389	13%	3% below market expectation
Profitability:				
	1Q20	1Q21		
Gross margin	36.6%	33.1%		
Net margin	2.8%	(2.9%)		
Core net margin	22.0%	15.1%		

Source(s): The Company, ABCI Securities



Investing for the future

Looking forward, the Company expects to generate a revenue exceeding RMB 930bn in FY3/22, implying a 30% YoY increase. It plans to use all incremental profits and additional capital in FY3/22 to support merchants and invest in new businesses and key strategic areas. In our view, this implies a potential capex/opex size of about RMB 20-40bn.

While this implies lower near-term profit growth, the actual financial impact would depend on the nature of investments (operating expenses/fixed assets/acquisition), which would lead to different P/L impacts.

Exhibit 2: Financial impact of various investments

Nature of investment	Example	Accounting treatment
Operating expenses	Customer rebate, merchants' support, etc.	Expensed in P/L
Fixed asset	Logistics infrastructures such as warehouse, distribution center, etc.	Depreciated over a number of year
Acquisition	Companies in niche market segment	Amortization of intangible asset but is excluded in core net profit calculation
Equity investment	Companies in niche market segment	Fair value changes excluded in core net profit calculation

Source(s): ABCI Securities

Indeed, the proposed investment plan is not entirely out of context comparing with Alibaba's past investment activities. E.g., it spent RMB 28.2bn on investment/acquisition/capex in FY3/21, accounting for 75% of the incremental core net profit for the year. In FY3/20, RMB 45.3bn was allocated to investment/acquisition/capex, accounting for 112% of the incremental core net profit for the year

Exhibit 3: Alibaba's investment trend (RMB m)

	FY3/19	FY3/20	FY3/21
Capex/Investment/acquisitions	49,643	45,386	28,285
Incremental core profit	14,965	40,613	37,610
Incremental net profit	23,615	61,663	1,045
As a % of incremental core profit	332%	112%	75%
As a % of incremental net profit	210%	74%	2707%

Source(s): Company, ABCI Securities

Overall, the Company plans to strengthen its support to merchants via providing more value-added technological services to increase loyalty. Community group purchase could be another key investment area as Meituan and Pinduoduo are currently ahead in terms of geographical coverage. In our view, this investment plan could lead to investors' concern over near-term profit growth outlook despite the potential long-term benefits on competitiveness.



Financial outlook

For FY3/21-23E, we expect GMV to grow at 13.8% CAGR to RMB 9.7bn by FY3/23, driven by the growing number of active users (CAGR 12.5%). We expect revenue to expand at 28% CAGR in FY3/21-23E. Among Alibaba's major business segments, core commerce would expand at 25% CAGR; revenue from cloud computing and media/innovative initiatives would grow at 60% and 13% CAGRs. Alibaba's revenue growth has been higher than the GMV growth in recent years, thanks to ongoing improvement in technological valued-added services to merchants. We expect this trend to continue.

Exhibit 4: Major assumptions

	FY3/20	FY3/21	FY3/22E	FY3/23E
Annual active buyers (mn)	726	811	933	1,026
Annual GMV per customer (RMB)	9,076	9,240	9,266	9,452
Total GMV (RMB bn)	6,589	7,494	8,642	9,697

Source(s): Company, ABCI Securities estimates

Exhibit 5: Revenue forecasts

(RMB mn)	FY3/20	FY3/21	FY3/22E	FY3/23E
China retail revenue	332,750	473,683	606,314	727,577
China wholesale	12,427	14,322	17,186	20,624
International commerce	33,917	48,851	61,064	76,330
Cainiao logistics	22,233	37,258	55,887	83,831
Consumer service (Ele.me)	25,440	31,537	36,268	41,708
Others	9,337	15,495	19,834	23,800
Core commerce	436,104	621,146	796,553	973,869
Cloud computing	40,016	60,120	96,192	153,907
Digital media/ Innovation initiatives	33,591	36,023	40,701	46,080
Total revenue	509,711	717,289	933,445	1,173,857

Source(s): Company, ABCI Securities estimates

Gross margin: We expect gross margin to decline from 41.3% in FY3/21 to 40.5% in FY3/23E due to ongoing investments in new businesses such as logistics and consumer services.

Product development expense: We expect non-GAAP product development expenses/sales ratio be 6.3% and 6.5% in FY3/22E and FY3/23E due to ongoing R&D investments in new services for merchants and consumers to increase merchants' loyalty.

Sales and marketing expenses: We expect non-GAAP sales and marketing expenses/sales ratio to remain largely stable at 9.0% in FY3/22-23E.

General & admin expenses: We expect non-GAAP general & admin expenses /sales ratio to stay at 3.5% in FY3/22-23E.

We expect core net margin (excl. impacts of share-based compensation and other non-operating items) to be 20.0% and 19.1% for FY3/22E and FY3/23E. This would result in a core net profit growth of 4.1% and 20.3% for FY3/22E and FY3/23E.



Exhibit 6: Non-GAAP cost trend (RMB mn)

(FY end Mar 31)	FY3/20	FY3/21	FY3/22E	FY3/23E
Cost of revenue	275,045	409,981	541,398	686,706
Product development expenses	29,426	35,762	58,807	76,301
Sales & marketing expenses	46,843	76,196	84,010	105,647
General & admin expenses	21,261	43,125	32,671	41,085
Amortization of intangible assets	13,964	12,427	24,270	30,520
Total	386,539	577,491	741,156	940,259
% of revenue				
Cost of revenue	54.0%	57.2%	58.0%	58.5%
Product development expenses	5.8%	5.0%	6.3%	6.5%
Sales & marketing expenses	9.2%	10.6%	9.0%	9.0%
General & admin expenses	4.2%	6.0%	3.5%	3.5%
Amortization of intangible assets	2.7%	1.7%	2.6%	2.6%
Total	75.8%	80.5%	79.4%	80.1%

Note: Excluding impacts of share-based compensation and other non-operating items

Source(s): Company, ABCI Securities estimates

Exhibit 7: Forecast changes for FY3/22E

(RMB mn)	old	new	Diff	Comment
Revenues	915,575	933,445	2%	
Core profit	200,961	186,279	(7%)	Higher cost assumption

Source(s): ABCI Securities estimates

Exhibit 8: Forecast changes for FY3/23E

(RMB mn)	old	new	Diff	Comment
Revenues	1,152,530	1,173,857	2%	
Core profit	249,516	224,170	(10%)	Higher cost assumption

Source(s): ABCI Securities estimates



Valuation and TP

We derive Alibaba’s valuation range based on the SOTP approach. For Alibaba’s core business, we apply a target multiple range of 20x-24x on its FY3/22E core profit. For its strategic investments, we refer to the latest book value and our estimates. The SOTP approach results in a valuation range of HK\$ 241-281 for Alibaba-SW (9988 HK).

Alibaba-SW (9988 HK): We set our TP at HK\$ 270.

Alibaba-ADR (BABA US): Based on our TP of Alibaba-SW, we set the corresponding TP of Alibaba-ADR at US\$ 278 (1 ADR represents 8 shares).

Overall, our valuation range implies a wide trading range. Our TP indicates a medium-term target but we notice that short-term share price might deviate from it due to regulatory uncertainties and technical factors such as supply/demand dynamics of shares, etc.

Exhibit 9: SOTP valuation range for Alibaba-SW (9988 HK)

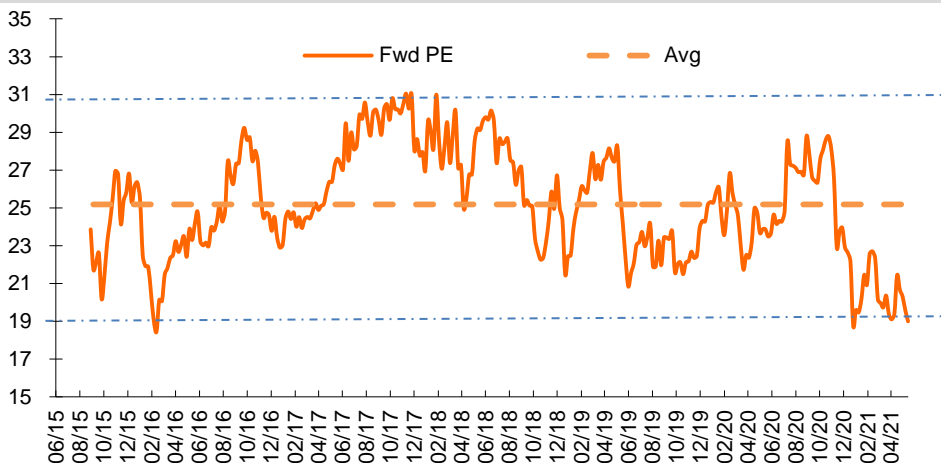
(HKD per share)	Low	High	Remarks
Core business	203	244	20-24x FY3/22E core profit
Strategic investments*	37	37	Latest book value, ABCI Securities estimates
Total	241	281	
Total (ex-Ant)	224	264	For reference only

*Including HK\$17 per share for the 33% stake in the Ant Group based on US\$ 150bn valuation (100%), which implies 8x 2019 P/S

Source(s): ABCI Securities estimates

The counter is currently trading near the low-end of its historical P/E band, which could provide some floor support amid weak near-term profit growth outlook. Having said that, we believe a mean reversion would take time as regaining investor confidence is a gradual process.

Exhibit 10: Alibaba’s fwd P/E



Source(s): Bloomberg, ABCI Securities



Exhibit 11: TP changes of Alibaba-SW (9988 HK) (HK\$ per share)

Old	New	Methodology -old	Methodology - new
320	270	SOTP	SOTP with revised financial forecast

Source(s): ABCI Securities estimates



Financial forecast

Consolidated income statement (FY20A-FY23E)

FY Ended Mar 31 (RMB mn)	FY20A	FY21A	FY22E	FY23E
Core commerce	436,104	621,146	796,553	973,869
Cloud computing & Internet infrastructure	40,016	60,120	96,192	153,907
Others	33,591	36,023	40,701	46,080
Total revenue	509,711	717,289	933,445	1,173,857
Cost of sales	(282,367)	(421,205)	(551,850)	(698,536)
Gross profit	227,344	296,084	381,595	475,321
Product development expenses	(43,080)	(57,236)	(78,804)	(98,933)
Selling & marketing expenses	(50,673)	(81,519)	(88,967)	(111,257)
General & admin expenses	(28,197)	(55,224)	(43,853)	(53,742)
Amortization/Impairment	(13,964)	(12,427)	(24,270)	(30,520)
Operating Profits	91,430	89,678	145,701	180,869
Interest and investment income	72,956	72,794	75,000	75,000
Interest expenses	(5,180)	(4,476)	(5,900)	(6,200)
Other income	7,439	7,582	-	-
Share of results of equity investees	(5,733)	6,984	1,000	1,000
Profit before tax	160,912	172,562	215,801	250,669
Tax	(20,562)	(29,278)	(34,528)	(45,120)
Profit after tax	140,350	143,284	181,273	205,548
Minority interests	9,083	7,294	9,064	10,277
Accretion of mezzanine equity	(170)	(270)	(321)	(364)
Profits attributable to ordinary shareholders	149,263	150,308	190,016	215,462
Share-based compensation	31,742	50,120	46,672	52,824
Amortization and impairment	39,044	27,164	24,270	30,520
Gains on disposals/revaluation of investments	(4,764)	(66,305)	(75,000)	(75,000)
Other non-core items	(73,941)	17,667	321	364
Non-GAAP profits attributable to ordinary shareholders (Core net profit)	141,344	178,954	186,279	224,170
Growth				
Total revenue (%)	35.3	40.7	30.1	25.8
Gross Profits (%)	33.8	30.2	28.9	24.6
Operating Profits (%)	60.2	(1.9)	62.5	24.1
Net profit (%)	70.4	0.7	26.4	13.4
Core net profit (%)	40.3	26.6	4.1	20.3
Operating performance				
Operating margin (%)	17.9	12.5	15.6	15.4
Net margin (%)	29.3	21.0	20.4	18.4
Core net margin (%)	27.7	24.9	20.0	19.1

Note. Individual items may not sum to total due to rounding differences

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY20A-FY23E)

As of Mar 31 (RMB mn)	FY20A	FY21E	FY22E	FY23E
Fixed assets	103,387	147,412	202,412	257,412
Investments	350,961	437,410	638,410	839,410
Other non-current assets	395,714	462,036	477,766	487,246
Total non-current assets	850,062	1,046,858	1,318,588	1,584,068
Cash & equivalents	330,503	321,262	303,142	385,941
Restricted cash and escrow receivables	15,479	35,207	35,207	35,207
Short-term investments and investment securities	32,712	162,183	162,183	162,183
Prepayments, deposits & other assets	84,229	124,708	124,708	124,708
Total current assets	462,923	643,360	625,240	708,039
Total assets	1,312,985	1,690,218	1,943,828	2,292,108
Accrued expenses, accounts payable and other liabilities	161,536	260,929	255,738	321,605
Other payables & accruals	23,204	25,486	25,486	25,486
Borrowings and notes	5,154	13,437	13,437	13,437
Deferred revenue	38,338	62,489	93,345	117,386
Merchants deposits	13,640	15,017	15,017	15,017
Total current liabilities	241,872	377,358	403,023	492,930
Borrowings and notes	120,276	135,716	135,716	135,716
Other non-current liabilities	71,186	93,510	93,510	93,510
Total non-current liabilities	191,462	229,226	229,226	229,226
Total liabilities	433,334	606,584	632,249	722,156
Net current assets	221,051	266,002	222,217	215,109
Mezzanine equity	9,103	8,673	8,994	9,357
Equity attributable to shareholders	755,401	937,470	1,174,158	1,442,444
Non-controlling interests	115,147	137,491	128,427	118,150
Total equity	870,548	1,074,961	1,302,586	1,560,594

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

Violation of the anti-monopoly law in China

According to State Administration for Market Regulation of the PRC (the “SAMR”), Alibaba has violated the anti-monopoly law, which states that a business operator that has a dominant market position is prohibited from restricting business counterparties through exclusive arrangements without justifiable cause.

The SAMR ordered Alibaba Group to cease violating acts and imposed on Alibaba a fine of RMB 18.228bn. The SAMR also issued an administrative guidance, instructing Alibaba Group to implement a comprehensive program of rectification through strictly fulfilling its responsibility as a platform operator, strengthening its internal controls and compliance, upholding fair competition, and protecting the lawful rights and interests of the platform’s merchants and consumers. The administrative guidance requires Alibaba Group to submit a self-assessment and compliance report to the SAMR for three consecutive years.

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.

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 ($\sim 10\%$)
Hold	- Market return rate ($\sim 10\%$) \leq Stock return rate $<$ Market return rate ($\sim 10\%$)
Sell	Stock return $<$ - Market return ($\sim 10\%$)

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 2008 (HSI total return index 2008-20 CAGR at 9.2%)

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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