27 Oct 2022

CMB International Global Markets | Equity Research | Company Update

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Alibaba (BABA US)

Consolidate strength, growing new horizons

Alibaba's earnings recovery will be aided by the streamlining of new businesses and operation optimization across business lines. Macro headwinds and low consumption sentiment dampened Alibaba's GMV growth of China commerce marketplace in 1H22, but we do expect gradual recovery in 2023, which could provide additional support for earnings recovery. International expansion and cloud business remain on track for long-term development, despite some short-term challenges. On a FY22-25E rev CAGR of 8.9%, we forecast non-GAAP NP CAGR of 6.0%. Our SOTP based TP of US$154.5 translates into 20.1x FY23E PE (non-GAAP). With current trading valuation of 8.2x FY23E PE (non-GAAP), risk-award is attractive. Maintain BUY.

- **China commerce: aiming to enhance value adding and efficiency.** For domestic business, Alibaba is streamlining its new businesses and improving operating efficiency, which would help to stabilise earnings. In 1QFY23, combined loss narrowed by RMB1.5bn for Taobao Deals and Freshippo, and the adjusted EBITA loss narrowed by RMB1.7bn for local consumer services business. Meanwhile, Alibaba is investing in its core China commerce marketplace to enhance customer experience, which helps fending off competition. With pandemic impact wanes and order cancellation rate returns to a normal range, gaps between the growth in China retail marketplace GMV and customer management revenue (CMR) could normalize. We forecast a FY22-25E CAGR of 4.4% for Alibaba's China retail marketplace GMV and 2.5% for its CMR.
- **Long-term growth of cloud business remains intact.** We are still positive on Alibaba Cloud's long-term revenue growth, due to its strong technology capability, the ramp-up of revenue generation from non-internet industries as well as international expansion which could provide support for long-term growth, in our view. We forecast a FY22-25E revenue CAGR of 14.8% for Alibaba Cloud. Driven by our expectation of further economies of scale, we forecast an adjusted EBITA margin of 2.0% for cloud business in FY23 (FY22: adj. EBITA margin of: 1.5%), with adj. EBITA of RMB1.8bn.
- **Inflection point on returning to positive earnings growth likely to kick-in in 2QFY23.** As Alibaba is focusing on quality growth in FY23, streamlining new businesses, and targeting for operating efficiency improvement across business lines, we forecast adjusted EBITA to grow by 10% to RMB143.5bn in FY23E. We expect the inflection point on positive earnings growth to be seen in 2QFY23. For adjusted EBITA margin, we estimate it to improve to 16.0% in FY23E (FY22: 15.3%).

Earnings Summary

(YE 31 Mar)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	717,289	853,062	896,587	1,004,333	1,101,364
YoY growth (%)	na	18.9	5.1	12.0	9.7
Net profit (RMB mn)	150,578.0	54,986.0	102,771.3	111,516.1	122,554.3
YoY growth (%)	na	(63.5)	86.9	8.5	9.9
Adjusted net profit (RMB mn)	178,954.0	143,515.0	144,910.8	156,711.0	171,014.3
YoY growth (%)	na	(19.8)	1.0	8.1	9.1
EPS (Adjusted) (RMB)	66.22	53.26	53.72	58.04	63.27
Consensus EPS (RMB)	66.22	53.26	51.87	59.86	68.22
P/E (x)	30.1	52.4	12.1	11.2	10.2
P/B (x)	4.9	3.0	1.1	1.0	0.9
ROE (%)	na	5.8	9.7	9.0	8.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**US$154.50**
Up/Downside	**144.4%**
Current Price	**US$63.22**

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Stock Data

Mkt Cap (US$ mn)	172,343.9
Avg 3 mths t/o (US$ mn)	86.7
52w High/Low (US$)	170.17/63.15
Total Issued Shares (mn)	2726.1

Source: FactSet

Shareholding Structure

SoftBank	23.9%

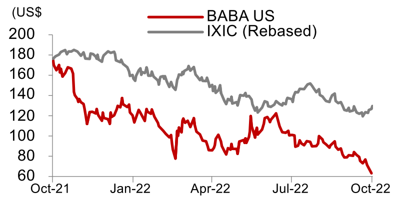
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-19.8%	-20.4%
3-mth	-37.4%	-32.7%
6-mth	-26.4%	-12.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

Contents

Earnings recovery has greater visibility

Alibaba's earnings are most sensitive to three factors, in our view: 1) further expansion of expenses in China commerce retail businesses, especially on Taobao Deals and Taocaicai; 2) investments on long-term opportunities, such as international expansion and technology enhancement (such as on cloud business); 3) overall company's operating leverage improvement rate.

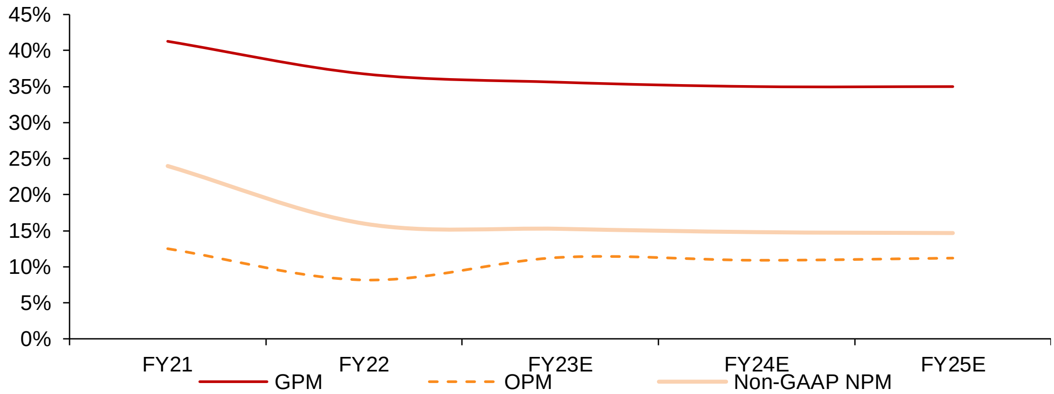
Alibaba's earnings are stabilizing supported by: 1) for domestic business, Alibaba is focusing on achieving quality growth, driving engagement of core user base, streamlining business operations and driving for operating efficiency improvement; 2) we expect macro stimulus policy will gradually transit to reinstate consumption growth, and Alibaba's China commerce marketplace GMV growth to start sequential gradual recovery from 2H22 onwards; 3) for international business, Alibaba is also driving for growth and efficiency improvement, such as Lazada.

According to management on 1QFY23 (financial year-end in March) earnings conference call, combined loss narrowed by RMB1.5bn YoY for Taobao Deals and Freshippo, and the adjusted EBITA loss narrowed by RMB1.7bn YoY for local consumer services business in 1QFY23. Although adjusted EBITA loss increased by RMB537mn YoY for international commerce business, loss generated from Lazada narrowed YoY, per management, driven by healthy revenue growth and operating efficiency improvement. We estimate Alibaba's non-GAAP net income to return to positive growth in 2QFY23, driven by operating efficiency improvement across business lines and streamlining loss-making new business.

Margins and earnings outlook forecast

Gross profit margin (GPM) declined by 4.5pp YoY to 36.8% in FY22, due to the revenue mix shift towards direct sales business. We forecast GPM to decline to 35.6% in FY23E, due to further revenue mix shift to direct sales business, and decline to 35.0% in over FY24-25E, driven by ongoing revenue mix shift to first party business.

Figure 1: Alibaba: gross, operating and non-GAAP net profit margin



Source: Company data, CMBIGM estimates

Alibaba's total adjusted EBITA declined by 23.5% YoY to RMB130.4bn in FY22, driven by Alibaba's strategic move to reinvest incremental profits and additional capital to support merchants, investment in new business, and enhance penetration of new addressable markets. As Alibaba is focusing on quality growth in FY23, streamlining new businesses, and targeting for operating efficiency improvement across business lines, we forecast adjusted EBITA to grow by 10% to RMB143.5bn in FY23E.

We estimate adjusted EBITA margin to improve to 16.0% in FY23E (FY22: 15.3%), driven by operating efficiency improvement and streamlining of loss-making new business.

■ Sensitivity analysis on revenue and earnings

We conduct a sensitivity analysis to gauge Alibaba's total revenue growth sensitivity to its GTV growth and change in take rate, which we identify as key drivers for customer management revenue growth.

Under our bull-case assumption, if GTV growth forecast was raised by 1/3/5/8pp in FY24E driven by better-than-expected recovery in consumption sentiment, and if monetization rate was raised by 0.1/0.3/0.5/0.8pp in FY24E aided by enhanced user stickiness, Alibaba's total revenue could have 1.2/3.5/6.0/9.7% upside in FY24E. Under our bear-case assumption, if GTV growth forecasts were lowered by 1/3/5/8pp in FY24E due to slower-than-expected recovery of macro environment, and take rate was lowered by 0.1/0.3/0.5/0.8pp due to intensified competition and likely launch of merchant support policies, Alibaba's total revenue could have 1.1/3.4/5.6/8.7% downside in FY24E.

Figure 2: Alibaba total revenue: sensitivity analysis

FY24E (RMBmn)	Change in GTV growth forecast (FY24E)	FY24E GTV growth	Change in take rate forecast (FY24E)	Increase in take rate (FY24E)	Other revenues	Total revenue	Comparison with base case
Case I	-8pp	0.1%	-0.8pp	-0.84pp	680,344	916,675	-8.7%
Case II	-5pp	3.1%	-0.5pp	-0.54pp	680,344	948,354	-5.6%
Case III	-3pp	5.1%	-0.3pp	-0.34pp	680,344	970,268	-3.4%
Case IV	-1pp	7.1%	-0.1pp	-0.14pp	680,344	992,819	-1.1%
Base case		8.1%		-0.04pp	680,344	1,004,333	0.0%
Case V	1pp	9.1%	0.1pp	0.06pp	680,344	1,016,005	1.2%
Case VI	3pp	11.1%	0.3pp	0.26pp	680,344	1,039,828	3.5%
Case VII	5pp	13.1%	0.5pp	0.46pp	680,344	1,064,287	6.0%
Case VIII	8pp	16.1%	0.8pp	0.76pp	680,344	1,102,168	9.7%

Source: Company data, CMBIGM estimates

We also conduct a sensitivity analysis to analyze Alibaba's non-GAAP net income sensitivity to its S&M expenses and G&A expenses. Under our bull-case assumption, if S&M expenses and G&A expenses growth forecasts were both decreased by 1/3/5/8pp in FY24E thanks to more effective than expected cost control measures, Alibaba's non-IFRS net income could increase by 0.8/2.3/3.8/6.1% in FY24E. Under our bear-case assumption, if S&M expenses and G&A expenses growth were raised by 1/3/5/8pp in FY24E as Alibaba enhanced its investment in China retail marketplace, international expansion as well as cloud, Alibaba's non-IFRS net income could decrease by 0.8/2.3/3.8/6.1% in FY24E.

Figure 3: Alibaba non-GAAP net income: sensitivity analysis

FY24E (RMBmn)	Change in S&M/ G&A expenses YoY growth	S&M expense YoY growth	G&A expense YoY growth	Implied S&M expense ratio	Implied G&A expense ratio	FY24E Non-GAAP NPM	FY24E Net profit	Comparison with base case
Case I	-8pp	5.8%	-1.7%	12.0%	3.4%	15.7%	157,785	6.1%
Case II	-5pp	8.8%	1.3%	12.3%	3.5%	15.4%	154,369	3.8%
Case III	-3pp	10.8%	3.3%	12.6%	3.6%	15.1%	152,092	2.3%
Case IV	-1pp	12.8%	5.3%	12.8%	3.7%	14.9%	149,815	0.8%
Base case		13.8%	6.3%	12.9%	3.7%	14.8%	148,676	0.0%
Case V	1pp	14.8%	7.3%	13.0%	3.7%	14.7%	147,538	-0.8%
Case VI	3pp	16.8%	9.3%	13.2%	3.8%	14.5%	145,261	-2.3%
Case VII	5pp	18.8%	11.3%	13.5%	3.9%	14.2%	142,983	-3.8%
Case VIII	8pp	21.8%	14.3%	13.8%	4.0%	13.9%	139,568	-6.1%

Source: Company data, CMBIGM estimates

Valuation: target price of US$154.5 per ADS

Our SOTP-based target price was US$154.5 per ADS, and translates into 20.1x FY23E PE.

1) US$101.6 per ADS for BABA's core commerce business (excluding cloud, local consumer services, and Cainiao), based on a DCF valuation (WACC of 11.7% and terminal growth of 2%);

2) US$26.0 per ADS for the cloud business, based on a 6.0x PS multiple on FY23E revenue. The 6.0x PS multiple is slightly lower than that of comparable peers at 6.7x for 2022E, as Alibaba Cloud's revenue growth was dampened in the near term due to soft macro, and strict pandemic prevention policy, which may cause a delay in deployment of hybrid cloud projects. But we are still positive on the long-term development of Alibaba Cloud, given its industry-leading technological capability, which helped established leading position in China Cloud market.

3) US$6.5 per ADS for Cainiao, based on the transaction in the most recent round of financing and Alibaba's 63% shareholding.

4) US$5.3 per ADS for local consumer services, based on a 2.0x PS on FY23 revenue. The 2.0x PS implies a discount to the current trading 2022E PS of 3.4x for Meituan, as Ele.me has a relatively lower market share.

5) US$15.0 per ADS for strategic investment with 30% holding discount.

Figure 4: Alibaba: SOTP valuation

Business	Method	Target PS	Valuation (US$mn)	Valuation per ADS (US$)	As % of total valuation
Core business (ex-cloud, Cainiao, and local consumer services)	DCF		277,082	101.6	65.8
Cainiao	Last round financing valuation, 63% shareholding		17,664	6.5	4.2
Local consumer services	PS, based on FY23 revenue	2.0	14,514	5.3	3.4
Alibaba Cloud	PS, based on FY23 revenue	6.0	70,897	26.0	16.8
Strategic investments	Market valuation, 30% holding discount applied to all investment		40,966	15.0	9.7
Total			**421,124**	**154.5**	

Source: CMBIGM estimates

Figure 5: Cloud computing: peers valuation comps

Companies	Ticker	Price	Revenue growth (YoY%)			PS(x)		
		(US$)	2022E	2023E	2024E	2022E	2023E	2024E
Microsoft	MSFT US	250.7	14.0	12.0	13.0	8.9	8.0	7.1
Google	GOOG US	104.9	(8.0)	12.3	12.8	5.7	5.1	4.5
Salesforce	CRM US	165.3	17.4	14.7	16.9	5.3	4.7	4.0
Average						**6.7**	**5.9**	**5.2**

Source: Bloomberg, CMBIGM
Note: data as of 25 October 2022

Figure 6: Food delivery: peers valuation comps

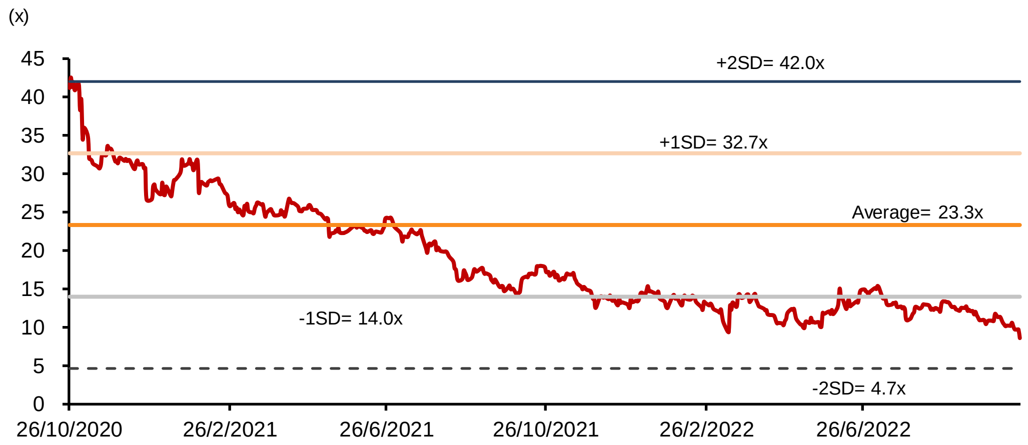
Companies	Ticker	Revenue growth (YoY%)			PS (x)		
		2022E	2023E	2024E	2022E	2023E	2024E
Meituan	3690 HK	9.9	30.5	24.1	3.4	2.6	2.1
DoorDash	DASH US	30.1	22.6	19.3	2.9	2.3	2.0
Delivery Hero	DHER GR	15.6	27.8	26.8	1.0	0.8	0.6
Just Eat Takeaway	TKWY NA	4.8	9.6	10.4	0.6	0.6	0.5
Average					**2.0**	**1.6**	**1.3**

Source: Bloomberg, CMBIGM
Note: data as of 25 October 2022

■ Valuation comparison

Alibaba is trading at 8.2x FY23E PE, vs three-year TTM average of 23.3x non-GAAP PE, which in our view could be mainly attributable to: 1) risk-off of foreign investors on China internet stocks due to geopolitical risks; and 2) macro headwinds which impacted consumer's consumption willingness. Alibaba's risk-reward is attractive at the current stage, in our view, and we expect recovery in macro and consumption sentiment, as well as the inflection point on earnings growth, aided by streamline of new business and operating efficiency improvement, to be catalyst for stock price.

Figure 7: Alibaba: non-GAAP PE band over the past three years (TTM)



Note: TTM: trailing twelve month
Source: Company data, Bloomberg, CMBIGM

Figure 8: E-commerce comps table

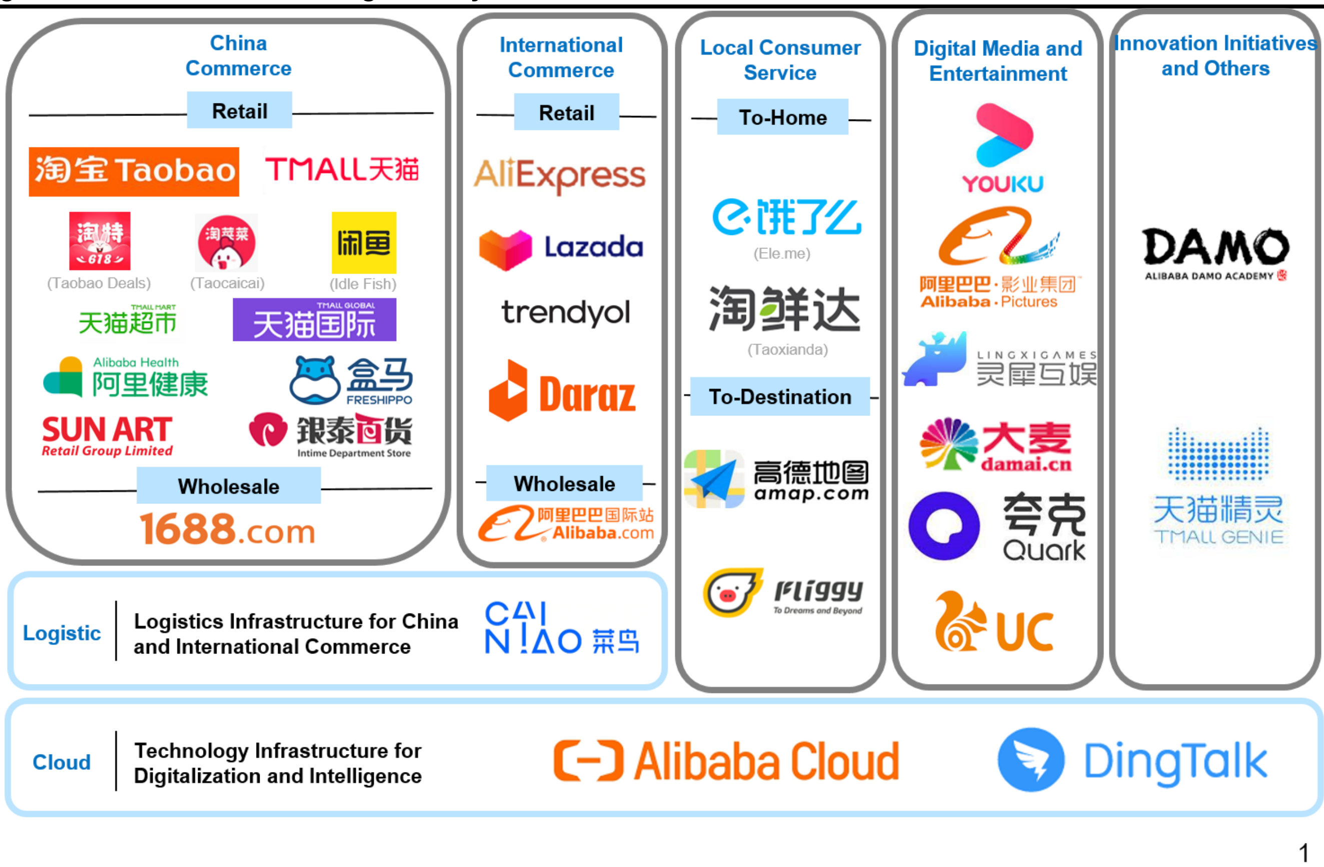
Companies	Ticker	Price	PE (x)			NP CAGR 2021-2024E	PEG (x)	PS(x)		
		(Local)	2022E	2023E	2024E		2022E	2022E	2023E	2024E
Alibaba Group	BABA US	63.2	8.2	7.6	6.9	6.0	1.4	1.3	1.2	1.1
JD.com	JD US	37.8	17.5	13.5	9.9	35.1	0.5	0.4	0.3	0.3
Pinduoduo	PDD US	47.5	13.9	11.4	9.6	48.2	0.3	3.5	2.9	2.5
Average			**13.2**	**10.8**	**8.8**		**0.7**	**1.7**	**1.5**	**1.3**

Source: Bloomberg, CMBIGM
Note: 1) data as of 25 October market close; 2) data are based on CMBIGM estimates; 3) we are using FY23-25E estimate for Alibaba (March year-end).; 4) data is based on non-GAAP measure.

Business segment forecast

With annual active buyers in China reached previous target of 1bn, Alibaba is shifting its investment focus to international expansion and technology enhancement. For domestic business, quality growth is the key word for FY23. For core Taobao and Tmall businesses, operation focus is on driving user engagement of core user base and enlarging consumer wallet share through enhancing customer services capability. For other businesses within China commerce retail, such as Taocaicai, Taobao Deals, Freshippo, and local consumer services, Alibaba targets for operating efficiency improvement and cost optimization, which likely enables greater visibility on earnings recovery. Meanwhile, Alibaba retains its investment in international expansion and technology enhancement to drive long-term revenue and earnings growth.

Figure 9: Alibaba: business segment layout

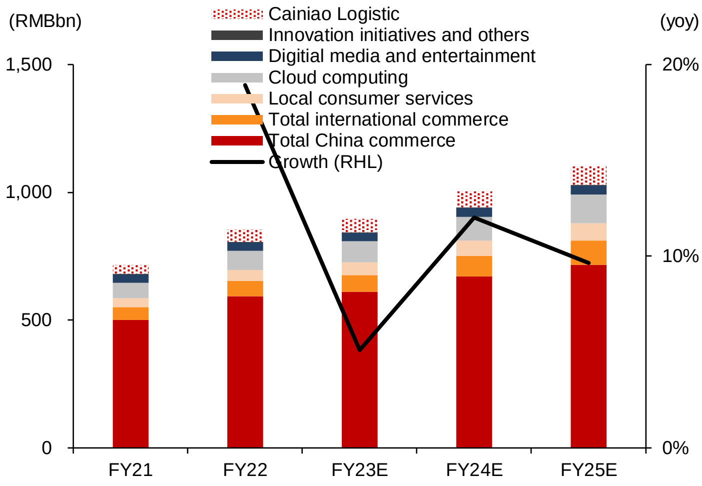


Source: Company data, CMBIGM

We forecast Alibaba to achieve a revenue CAGR of 8.9% in FY22-FY25 to reach RMB1.1tn revenue in FY25, and a non-GAAP net profit attributable to ordinary shareholders CAGR of 6.0% to reach RMB171.0bn in FY25E. In terms of revenue contribution, we forecast China commerce to remain the key contributor with 68.1% of revenue contribution in FY23E, but to gradually decline to 65.1% in FY25E. We forecast cloud computing business to achieve FY22-25E revenue CAGR of 14.8%, and to grow from 8.7% in FY22 to 10.3% in FY25E in terms of revenue contribution.

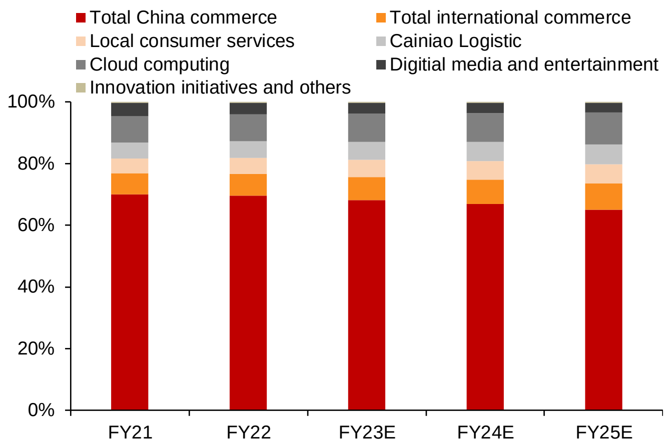
For international commerce, we estimate a combined revenue CAGR of 15.4% over FY22-25E for retail and wholesale businesses, and to grow its revenue contribution from 7.2% in FY22 to 8.5% in FY25E.

Figure 10: Alibaba: total revenue and growth



Source: Company data, CMBIGM estimates

Figure 11: Alibaba: revenue breakdown

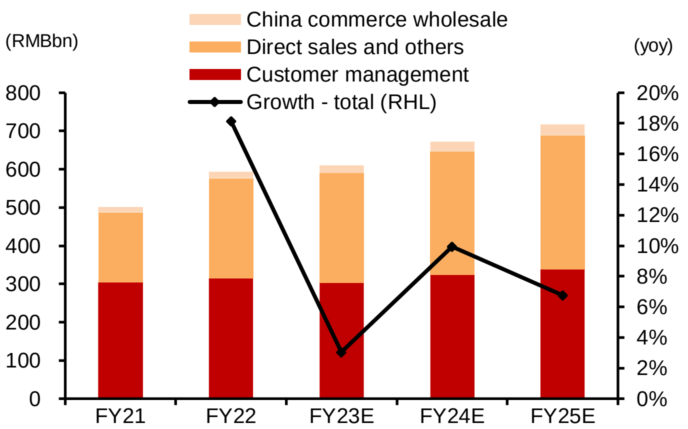


Source: Company data, CMBIGM estimates

China commerce (68.1% of FY23E revenue)

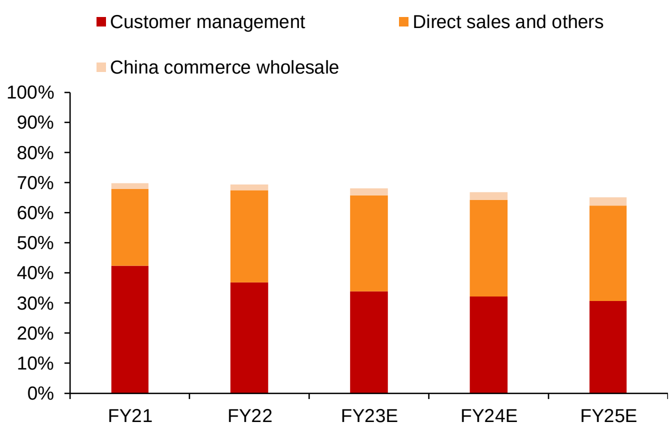
We forecast Alibaba's China commerce revenue to deliver a CAGR of 6.5% in FY22-25E, for total revenue of RMB716.8bn in FY25E. More specifically, we estimate customer management revenue, direct sales and others, and China commerce wholesale to record revenue CAGRs of 2.5%, 10.2%, and 19.5%, respectively, over the same period.

Figure 12: Alibaba: China commerce revenue and growth



Source: Company data, CMBIGM estimates

Figure 13: Alibaba: China commerce revenue as% of total revenue



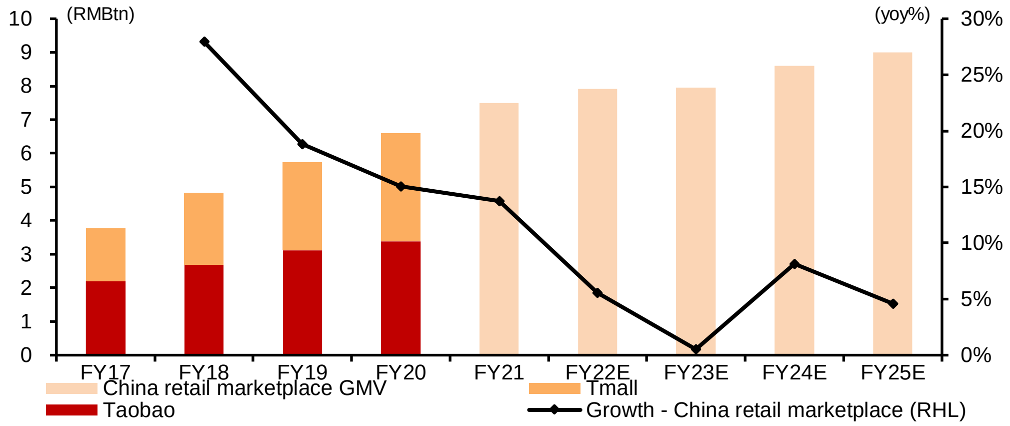
Source: Company data, CMBIGM estimates

- **Customer management revenue (33.8% of FY23E revenue)**

Alibaba's customer management revenue primarily consists of: 1) P4P marketing services, where merchants primarily bid for keywords that match product or service listings appearing in search results through Alibaba's online auction system on a cost-per-click basis; 2) in-feed marketing services; 3) commission on transactions; and 4) Taobaoke program.

We expect Alibaba's customer management to see healthy revenue growth in FY22-FY25, thanks to steady China retail marketplace GMV growth, aided by increase in online penetration of different categories, such as fast-moving consumer goods and home furnishings, and increase in cross-sale of different categories among existing user group aided by enhanced customer services capability, which should enable consumer mindshare gain. We forecast a FY22-FY25 CAGR of 4.4% for Alibaba's China retail marketplace GMV and 2.5% for its CMR.

Figure 14: Alibaba: China retail marketplace GMV forecast



Source: Company data, CMBIGM estimates

■ **Direct sales and others (32.0% of FY23E revenue)**

Alibaba's direct sales and other revenue from China commerce retail is primarily generated by direct sales businesses, mainly comprising Sun Art, Tmall Supermarket, and Freshippo. In FY22, revenue generated from direct sales and others was RMB261.0bn, up 43% YoY, or 28% YoY if excluding the impact from consolidation of Sun Art business.

By leveraging its multiple direct sales businesses, Alibaba has developed diversified fulfillment networks and is able to offer time guaranteed delivery, same-day delivery, and next day delivery in China. By leveraging on-demand instant delivery capability, the online proportion of Sun Art's revenue increased by 5pp to 29%, while Freshippo's online GMV contribution remained at over 60% in FY22, per company data.

We forecast FY22-25E revenue CAGR of 10.2% for direct sales and others business, with total revenue to reach RMB349.5bn in FY25, aided by the robust revenue growth of Freshippo and Tmall Supermarket.

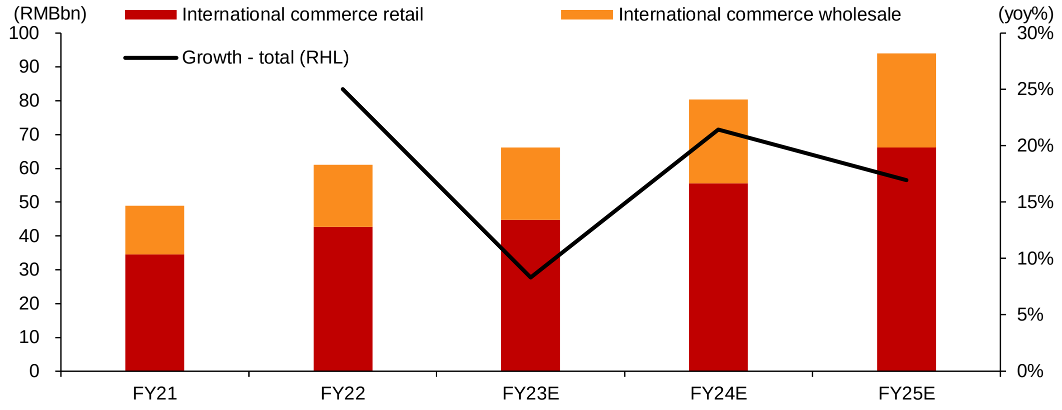
International commerce (7.4% of FY23E revenue)

Alibaba's international commerce business segment is comprised of international commerce retail business and international commerce wholesale business. International commerce retail businesses mainly include Lazada, AliExpress, Trendyol and Daraz, and Alibaba.com is the key business pillar in international commerce wholesale business.

In terms of revenue generation, Alibaba generates revenue from international commerce retail businesses primarily through logistics services, direct sales, commissions on transactions and P4P marketing services. Logistics services and direct sales revenue was primarily generated from Lazada and Trendyol, and commission revenue is mainly contributed by transactions on AliExpress and Trendyol. In addition, Alibaba generates P4P marketing services revenue from AliExpress and Lazada's organic traffic and its collaboration with third-party websites and mobile apps.

Revenue generated from international commerce was RMB61.1bn in FY22, up 25.0% YoY, among which that from retail business was RMB42.7bn, up 24% YoY, mainly driven by robust revenue growth of Lazada, and that from wholesale was RMB18.4bn, up 28% YoY, due to increases in both the average revenue from paying members and the number of paying members on Alibaba.com, as well as an increase in revenue generated by cross-border related value-added services. We forecast FY22-25E revenue CAGR of 15.8% for international commerce retail business, and revenue CAGR of 14.7% for international commerce wholesale business, underpinning a 15.4% CAGR of international commerce business segment.

Figure 15: Alibaba: international commerce revenue



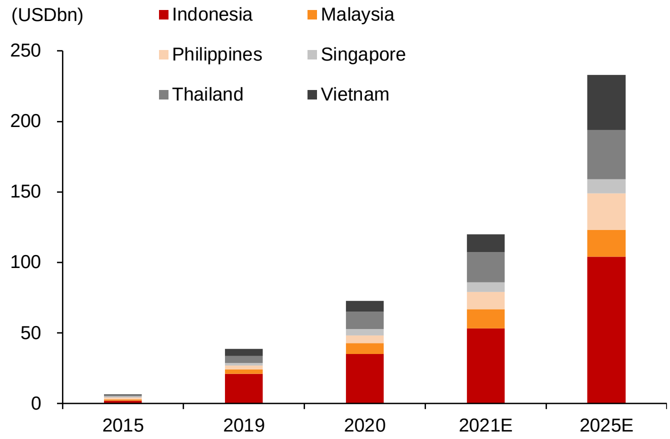
Source: Company data, CMBIGM estimates

In 1QFY23, operation results of international commerce are mixed. Revenue from international commerce retail business was RMB10.5bn, down 3% YoY, owing to the declining orders of AliExpress due to change in the European Union's VAT rules, depreciation of Euro against US dollar as well as ongoing supply chain and logistics disruptions due to the Russia-Ukraine conflict, while partly offset by the increase in revenue contributed by Lazada, whose order saw YoY growth of 10%. Revenue generated from international commerce wholesale business was RMB4.9bn in 1QFY23, up 12% YoY, primarily driven by increase in revenue generated by cross-border related value added services.

Although facing short-term headwinds on driving business development, international expansion remains one of the key initiatives to drive long-term revenue and earnings growth. We believe international commerce, especially for regions like Southeast Asia (SEA), where Alibaba's Lazada mainly operates, has abundant potential to achieve further growth. Based on a report jointly published by Temasek, Bain and Google (10 November 2021), overall e-commerce market GMV for the SEA market reached US$74bn in 2020, up 95% YoY, compared with RMB11.8tn total online retail sales GMV for China with 10.9% YoY growth in 2020. The report estimated a SEA e-commerce GMV CAGR for 2020-2025E of 26%, with GMV of US$234bn in 2025E.

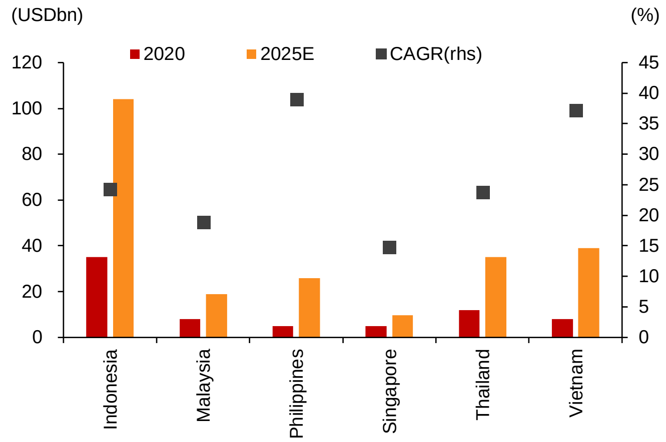
Among the six countries in SEA, Indonesia's e-commerce market GMV is the largest. It amounted to US$35bn in 2020, and is expected to achieve a 2020-2025 CAGR of 24%, reaching US$104bn in 2025, per the report. Philippines/Vietnam e-commerce market GMV is expected to achieve higher than geographic average CAGR of 39/37% over 2020-2025.

Figure 16: Southeast Asia: e-commerce GMV by countries



Source: Temasek/Bain/Google report, CMBIGM

Figure 17: Southeast Asia: 2021-2025E CAGRs for e-commerce GMV



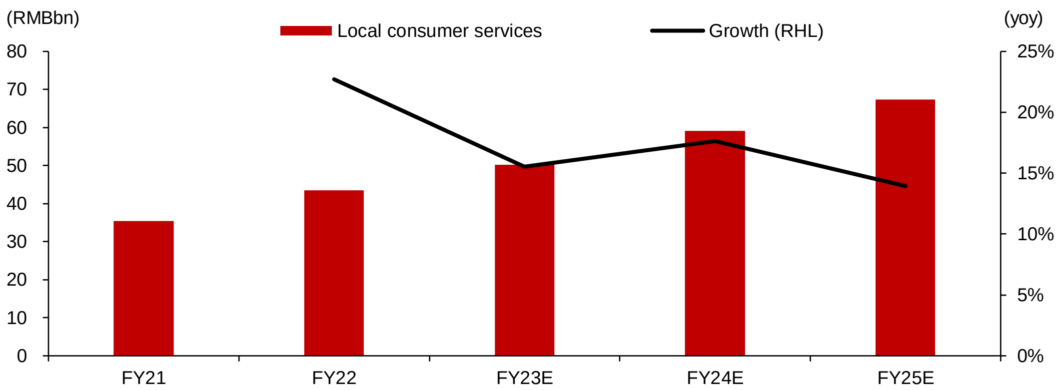
Source: Temasek/Bain/Google report, CMBIGM estimates

In terms of online penetration of retail sales, we believe there is still abundant upside potential for the SEA market. According to TMO Group, eMarketer, and Toubao, online penetration of retail sales for each of the countries in SEA was less than 5% in 2020, compared with that of 24.9% for China (per NBS data), which in our view indicates abundant room for improvement. Alibaba's strong technological capability, and know-how in operating e-commerce business, could together provide solid support for its business expansion in SEA, in our view.

Local consumer services (5.6% of FY23E revenue)

Local consumer services mainly include location-based services, such as Ele.me, Amap, Fliggy and Taoxianda. Revenue generated from local consumer services was RMB43.5bn in FY22, up 23% YoY, primarily driven by the growth in GMV. We forecast FY22-25E revenue CAGR of 15.7% for local consumer services, with revenue to reach RMB67.3bn in FY25E.

Figure 18: Alibaba: local consumer services revenue

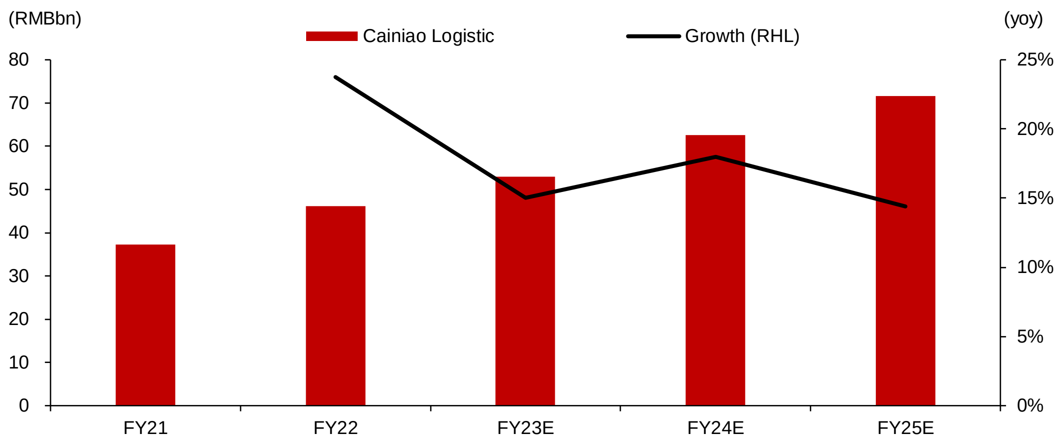


Source: Company data, CMBIGM estimates

Cainiao logistics (5.9% of FY23E revenue)

Revenue generated from Cainiao Logistics was RMB46.1bn in FY22, up 23.8% YoY, and management attributed the robust growth primarily to the increases in both volume of orders fulfilled and penetration of cross-border and International commerce retail businesses, the increase in revenue from value-added services provided to external merchants, as well as increase in revenue from consumer logistics services as a result of service upgrade to enhance consumer experience. Prompted by the expanding coverage of Cainiao Post, and the increasing adoption of "Fulfilled by Cainiao", we forecast Cainiao Logistics revenue to achieve a FY22-25 CAGR of 15.8%, with revenue to reach RMB71.6bn in FY25E.

Figure 19: Alibaba: Cainiao Logistics revenue



Source: Company data, CMBIGM estimates

Cloud computing (9.1% of FY23E revenue)

Overall cloud industry revenue growth slowed down in 1H22, due to macro headwinds that impacted Chinese enterprises' budget for digitalization, as well as pandemic resurgence which caused delay to deployment of hybrid cloud project. However, over the mid-to-long term, we remains upbeat on the development of cloud business in China, as moving on to cloud could effectively help companies improve business flexibility and achieve effective cost control.

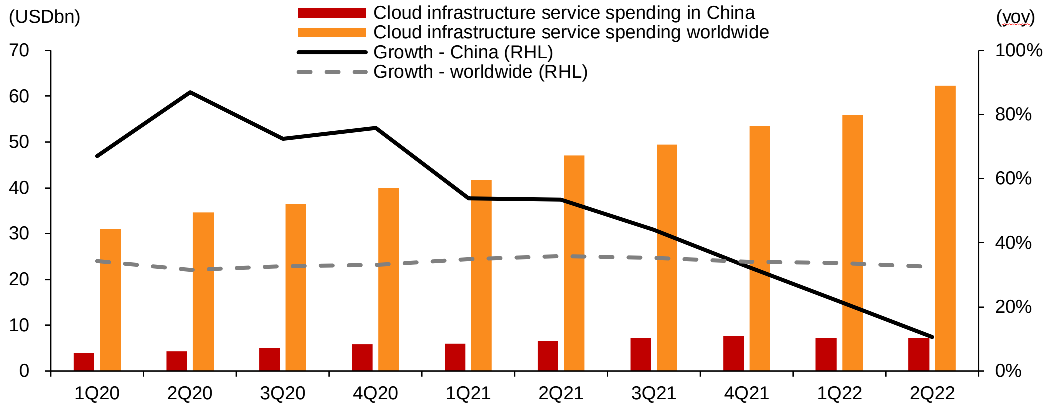
For Alibaba Cloud, although its revenue growth also slowed in the near term, which is inline with industry trend, it sees additional challenges from: 1) decline in revenue from a top internet customer that has gradually stopped using Alibaba Cloud's overseas cloud services for its international business due to non-product related requirements; 2) decline in revenue generation from online education customers; and 3) softening demand from other customers in China's internet industry. However, we are still positive on Alibaba Cloud's long-term revenue growth, as it has strong technological capability, and the ramp-up of revenue generation from non-internet industries could provide support for long-term revenue growth, in our view.

- **China cloud: long-term digitalization intact despite short-term headwinds**

In 1H22, cloud services revenue growth was impacted by the softened macro and pandemic resurgence. According to Canalys, cloud infrastructure services spending grew by merely 11% YoY in China in 2Q22 (2Q21: 54%; 1Q22: 22%), as compared to 33% YoY growth for global market (2Q21: 36%; 1Q22: 34%). Cloud infrastructure services spending in China accounted for 11.7% of the global total in 2Q22, down 1.3pp QoQ and 2.3pp YoY.

Looking ahead, a gradual recovery in macro could drive for a recovery in enterprise's digitization budget, and rising digitization demand from emerging industries such as new energy, smart manufacturing and other fields may help revive revenue growth for cloud computing industry. Over the long run, we believe enterprises' demand for cost optimization and efficiency enhancement should remain steady, and traditional industries other than the Internet industry (such as manufacturing, retail, etc) are showing solid digital transformation needs, which could drive continuous expansion of China's cloud computing market in our view.

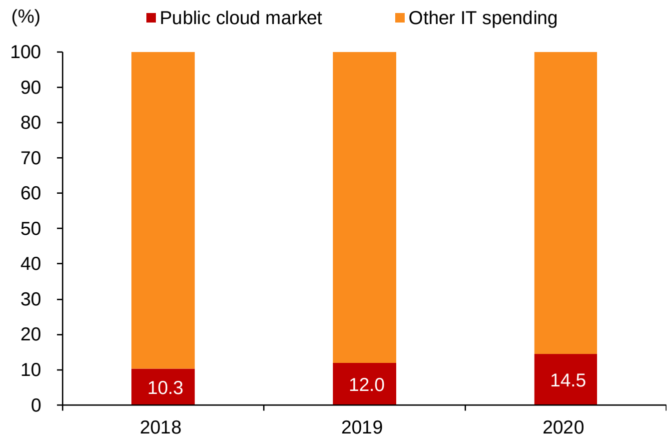
Figure 20: Cloud infrastructure services spending and growth in China and worldwide



Source: Canalys, CMBIGM

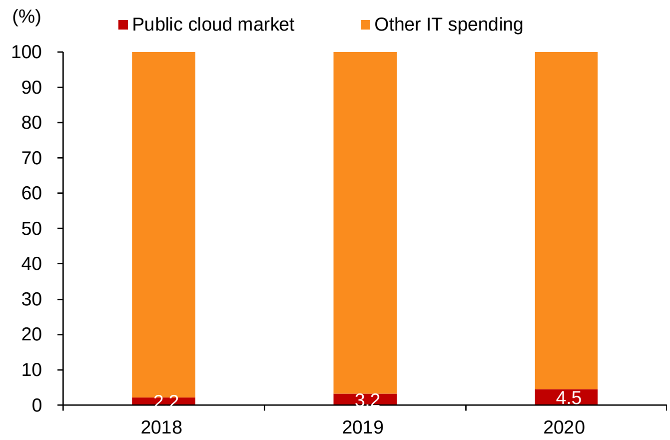
We are still positive on the long-term growth potential of China's cloud services, as compared with local deployment, the agility and elasticity of cloud services in our view could support enterprises to improve business flexibility and achieve effect cost control. A comparison between the US and China also suggests that China's cloud market has potential to grow. According to data from Gartner and Statista, the Chinese public cloud market accounted for about 4.5% of China's overall IT spending in 2020, a further increase from 3.2% in 2019, but still representing room for improvement in our view, as that number reached 14.5% in the US in 2020.

Figure 21: US: public cloud services as a % of total IT spending



Source: Statista, CMBIGM

Figure 22: China: public cloud services as % of total IT spending



Source: Gartner, CMBIGM

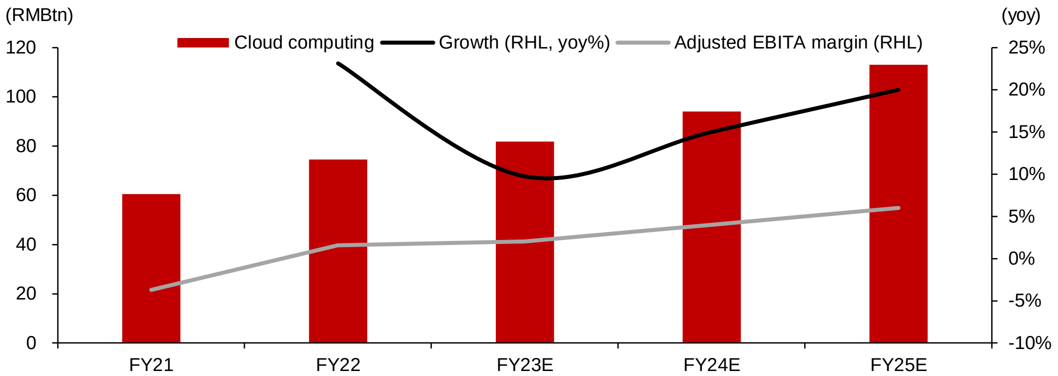
■ **Alibaba Cloud: we forecast a FY22-25E revenue CAGR of 14.8%**

Revenue from cloud computing business reached RMB74.6bn in FY22, up 21% YoY (FY20: 51%). The moderation of YoY revenue growth was because a top customer in the internet industry gradually phased out using Alibaba's cloud services for its international business due to non-product related reasons, as well as slowing demand from customers in China's Internet industry, according to results announcement.

On the bright side, Alibaba's cloud segment revenue is becoming more diversified with steady increase in revenue contribution from non-Internet industries. Per company data, cloud revenue contribution from non-internet industry was 53% in 1QFY23, up 5pp YoY and 1pp QoQ. We expect digitalization demand to optimize cost and could propel an increase in adoption of cloud services, which is likely to drive steady revenue growth of overall cloud industry. Alibaba cloud has strong technological capability, in our view, and could also benefit from the trend of digitalization. We forecast a revenue CAGR of 14.8% for cloud computing business over FY22-25E.

The business's adjusted EBITA was RMB1.1bn in FY22, implying an adjusted EBITA margin of 1.5%, compared to an adjusted EBITA loss in FY21 of RMB2.3bn with a loss margin of 3.7%, primarily due to the realization of economies of scale, while partly offset by increased investment in DingTalk. Driven by our expectation of further economies of scale, we forecast an adjusted EBITA margin of 2.0% in FY23, with adjusted EBITA of RMB1.6bn.

Figure 23: Alibaba: cloud computing revenue and adjusted EBITA margin



Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (RMB mn)						
Revenue	**na**	**717,289**	**853,062**	**896,587**	**1,004,333**	**1,101,364**
Cost of goods sold	na	(421,205)	(539,450)	(577,402)	(652,816)	(715,887)
Gross profit	**na**	**296,084**	**313,612**	**319,185**	**351,516**	**385,477**
Operating expenses	**na**	**(206,406)**	**(243,974)**	**(217,871)**	**(242,044)**	**(262,125)**
SG&A expense	na	(136,743)	(151,721)	(148,833)	(166,719)	(180,624)
R&D expense	na	(57,236)	(55,465)	(58,278)	(64,277)	(69,386)
Others	na	(12,427)	(36,788)	(10,759)	(11,048)	(12,115)
Operating profit	**na**	**89,678**	**69,638**	**101,314**	**109,472**	**123,353**
Interest income	na	72,794	(15,702)	8,966	9,039	8,811
Interest expense	na	(4,476)	(4,909)	(5,380)	(6,026)	(6,388)
Other income/expense	na	7,582	10,523	7,173	7,030	6,058
Pre-tax profit	**na**	**165,578**	**59,550**	**112,073**	**119,516**	**131,833**
Income tax	na	(29,278)	(26,815)	(26,337)	(28,086)	(32,958)
Others	na	6,984	14,344	8,966	12,052	14,318
After tax profit	**na**	**143,284**	**47,079**	**94,702**	**103,481**	**113,193**
Minority interest	na	7,294	7,907	8,069	8,035	9,362
Net profit	**na**	**150,578**	**54,986**	**102,771**	**111,516**	**122,554**
Adjusted net profit	**na**	**178,954**	**143,515**	**144,911**	**156,711**	**171,014**

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (RMB mn)						
Current assets	**na**	**643,360**	**638,535**	**730,378**	**829,308**	**950,431**
Cash & equivalents	na	321,262	189,898	290,558	374,007	481,483
Restricted cash	na	35,207	37,455	37,455	37,455	37,455
Prepayment	na	124,708	145,995	137,178	152,659	166,306
Financial assets at FVTPL	na	162,183	265,187	265,187	265,187	265,187
Non-current assets	**na**	**1,046,858**	**1,057,018**	**1,117,812**	**1,204,427**	**1,285,201**
PP&E	na	147,412	171,806	213,487	244,500	268,651
Investment in JVs & assos	na	200,189	219,642	248,061	279,566	313,337
Intangibles	na	70,833	59,231	104,794	124,900	143,939
Goodwill	na	292,771	269,581	269,581	269,581	269,581
Financial assets at FVTPL	na	237,221	223,611	223,611	223,611	223,611
Other non-current assets	na	98,432	113,147	58,278	62,269	66,082
Total assets	**na**	**1,690,218**	**1,695,553**	**1,848,190**	**2,033,735**	**2,235,633**
Current liabilities	**na**	**377,358**	**383,784**	**360,891**	**402,226**	**447,504**
Short-term borrowings	na	3,606	8,841	9,463	10,699	11,733
Tax payable	na	25,275	21,753	24,757	24,716	28,015
Other current liabilities	na	87,337	81,730	84,593	95,642	104,882
Accrued expenses	na	261,140	271,460	242,078	271,170	302,875
Non-current liabilities	**na**	**229,226**	**229,576**	**207,889**	**214,471**	**221,553**
Long-term borrowings	na	38,335	38,244	38,244	38,244	37,407
Deferred income	na	3,158	3,490	3,736	4,223	4,631
Other non-current liabilities	na	187,733	187,842	165,910	172,004	179,515
Total liabilities	**na**	**606,584**	**613,360**	**568,781**	**616,698**	**669,057**
Share capital	na	1	1	1	1	1
Capital surplus	na	394,308	410,506	520,454	554,601	590,946
Retained earnings	na	554,924	563,557	666,328	777,844	900,399
Other reserves	na	(3,090)	(15,930)	(23,364)	(23,364)	(23,364)
Total shareholders equity	**na**	**946,143**	**958,134**	**1,163,419**	**1,309,083**	**1,467,982**
Minority interest	na	137,491	124,059	115,990	107,955	98,593
Total equity and liabilities	**na**	**1,690,218**	**1,695,553**	**1,848,190**	**2,033,735**	**2,235,633**

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar (RMB mn)						
Operating						
Profit before taxation	**na**	**165,578**	**59,550**	**112,073**	**119,516**	**131,833**
Depreciation & amortization	na	47,909	27,618	29,142	33,264	41,931
Tax paid	na	(29,278)	(26,815)	(26,337)	(28,086)	(32,958)
Change in working capital	na	50,297	(22,540)	16,242	22,753	30,976
Others	na	(2,720)	104,946	33,623	38,604	40,072
Net cash from operations	**na**	**231,786**	**142,759**	**164,744**	**186,051**	**211,854**
Investing						
Capital expenditure	na	(41,450)	(3,412)	(3,138)	(3,013)	(3,304)
Acquisition of subsidiaries/ investments	na	(1,735)	(7,964)	(31,154)	(31,154)	(31,154)
Net proceeds from disposal of short-term investments	na	(114,826)	104,138	0	0	0
Others	na	(86,183)	(291,354)	(67,869)	(69,670)	(70,116)
Net cash from investing	**na**	**(244,194)**	**(198,592)**	**(102,161)**	**(103,837)**	**(104,574)**
Financing						
Net borrowings	na	32,008	0	0	0	0
Proceeds from share issues	na	175	16,198	0	0	0
Share repurchases	na	(773)	0	0	0	0
Others	na	(1,328)	(80,647)	622	1,236	196
Net cash from financing	**na**	**30,082**	**(64,449)**	**622**	**1,236**	**196**
Net change in cash						
Cash at the beginning of the year	na	345,982	356,469	227,353	290,558	374,007
Exchange difference	na	(7,187)	(8,834)	0	0	0
Cash at the end of the year	**na**	**356,469**	**227,353**	**290,558**	**374,007**	**481,483**

GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Revenue	na	na	18.9%	5.1%	12.0%	9.7%
Gross profit	na	na	5.9%	1.8%	10.1%	9.7%
Operating profit	na	na	(22.3%)	45.5%	8.1%	12.7%
Net profit	na	na	(63.5%)	86.9%	8.5%	9.9%
Adj. net profit	na	na	(19.8%)	1.0%	8.1%	9.1%

PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Gross profit margin	na	41.3%	36.8%	35.6%	35.0%	35.0%
Operating margin	na	12.5%	8.2%	11.3%	10.9%	11.2%
Adj. net profit margin	na	24.9%	16.8%	16.2%	15.6%	15.5%
Return on equity (ROE)	na	na	5.8%	9.7%	9.0%	8.8%

GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
Net debt to equity (x)	na	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Current ratio (x)	na	1.7	1.7	2.0	2.1	2.1

VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Mar						
P/E	na	30.1	52.4	12.1	11.2	10.2
P/E (diluted)	na	30.6	53.0	12.3	11.3	10.3
P/B	na	4.9	3.0	1.1	1.0	0.9
P/CFPS	na	24.2	20.9	7.8	6.9	6.1

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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