Alibaba Group 阿里巴巴集团

BUILDING BENJAMINS

Alibaba's Phenomenal Growth and Compelling Nominal Valuation Create an Opportunity for Investors

Price $216.40 **Recent Add** **June 7, 2021**

- Leading online retailer in China which continues to grow rapidly.
- Explosive growth driven by growing middle class and increasing digitalization of Chinese economy.
- Leveraging its e-commerce base to expand into traditional brick-and-mortar retail.
- A dominant force in cloud computing and logistics in China.

Investment Thesis

Alibaba Group (BABA) leads the Chinese market with its desirable growing middle class. BABA's sells to over 800 million customers in China but also has 60% of publicly listed Chinese companies working with them in their value chain in some capacity: cloud services, logistics, or wholesale. Alibaba is an attractively valued growth investment, in our opinion, for multi-year capital appreciation.

What is Alibaba?

Alibaba has grown into one of the world's largest e-commerce giants. Jack Ma started the company out of his apartment in 1999. Ma saw that the internet would be a revolution in commerce and would massively improve the ease at which everyone – the largest businesses to individual consumers – went about purchasing products. Alibaba does everything from selling groceries to operating 60% of China's cloud architecture. With China having a growing middle class, there is explosive demand for internet-based marketplaces and entertainment.

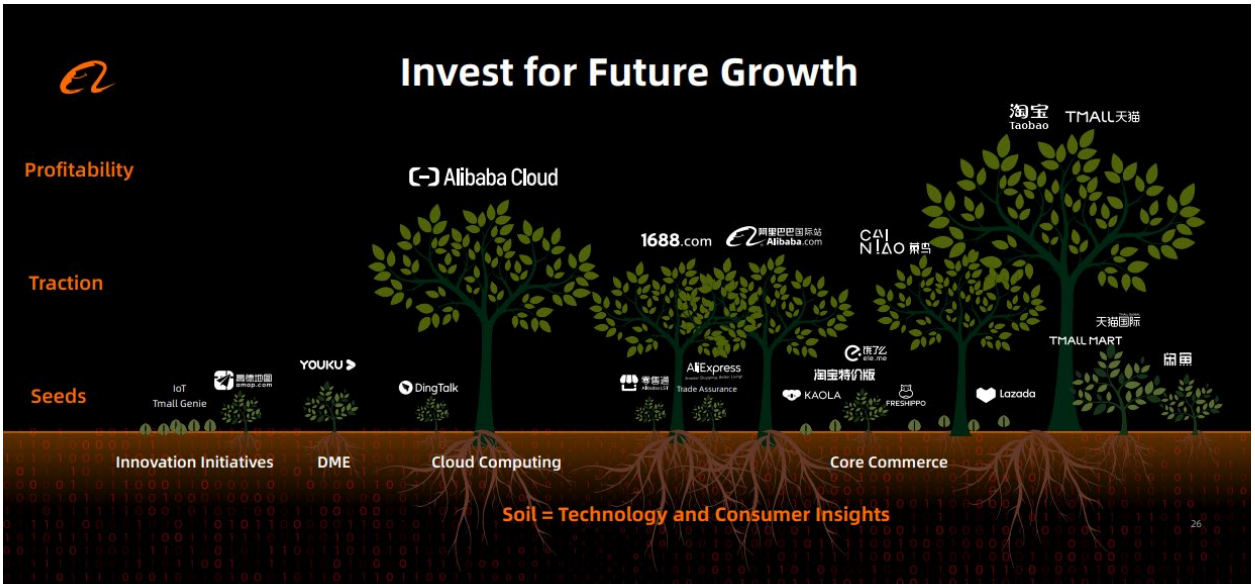


Image: Financial Investment Perspective investor day 2020

BABA invests more than $5 billion a year in marketing intelligence and product development. It has also made over $2 billion in acquisitions of promising companies and technology. BABA expects to have 2 billion customers within the next decade.

Retail Commerce - China

China dominates BABA's revenues and represents 70% of the total with 891 million customers. The largest share of revenue comes from its retail marketplaces, primarily Taobao and Tmall. They have an incredible 98% retention rate for customers that spend over $1,000, and 67% for customers that spend under $300. Chinese urban market penetration is estimated to be 90% with 45% rural penetration. Rural customers represent 70% of their new customers.

Taobao is the largest mobile commerce marketplace, operating like Etsy or eBay, where individual sellers sell to individual customers. Tmall is similar to Amazon, where businesses can list their products and deliver them to customers.

Tmall has far outpaced traditional retailers in China, using advanced data metrics to extend reach to customers. They estimate this improves revenue per customer by 15%. To open a store on Tmall, brands and retailers need to open a "flagship" store, where brands or retailers can list individual categories of products for customers to browse. So far, over 120,000 traditionally brick-and-mortar Chinese retailers have opened one of these "flagships" on Tmall.

Category	Tmall Q1 2021	Traditional Chinese Retail Q1 2021
Apparel	+ 17%	- 8%
Consumer Goods	+ 40%	+ 6%
Consumer Electronics	+ 27%	+ 6%

Chart from: BABA Investor Day 2020

On Tmall, there is a wide support program for new brands being launched and marketing for existing products, allowing businesses to quickly be matched with the right customers. This includes Tmall Mart, which is a new initiative, allowing the model of Tmall to be extended to grocers.

A recent acquisition is Kaola, formerly a direct competitor to Tmall Global, an importer of foreign goods in China. Both of these services allow non-Chinese companies to sell their goods to Chinese customers. This allows Chinese customers access to authorized foreign goods, while reducing entry costs for non-Chinese companies.

In addition to the impressive growth Tmall has experienced, nearly 7 million users have opened shops on Taobao, marking a 20% increase since last year. Taobao is considered a customer-to-customer retailer, which allows county-level shops to be used, which farmers and local businesses have capitalized on. This allows local businesses to leverage Taobao's base and logistics services to deliver goods locally. Amazingly, this has a customer 7-day repurchase rate of 77%, which they hope to grow with better customer insight and expansion of stores offered. Taobao incubates over 200 "influencer original" brands that have been successfully launched. Interestingly, Taobao attempts to foster parasocial relationships with products they market, encouraging even farmers to become "influencers" to market their products better.

Alibaba's origins as an online-only retailer have morphed into both online and brick-and-mortar stores. One example is several Freshippo stores, already having 227 at the end of 2020, and 25 million active customers. These stores have had a massive 32% increase in sales per square meter and have an extensive list of brands that customers can shop in person. Alternatively, customers can order online and have it be delivered or pick it up in-store.

These domestic commerce operations have experienced growth exceeding 20% in both customers and revenue.

Retail Commerce – Global

Lazada is a fast-growing e-commerce platform that was recently acquired. It is primarily marketed at Southeast Asian markets, outside of China. Across the company, sales have grown over 100% year over year, bolstered heavily by the growing southeast Asian middle class, which is expected to double by 2030.

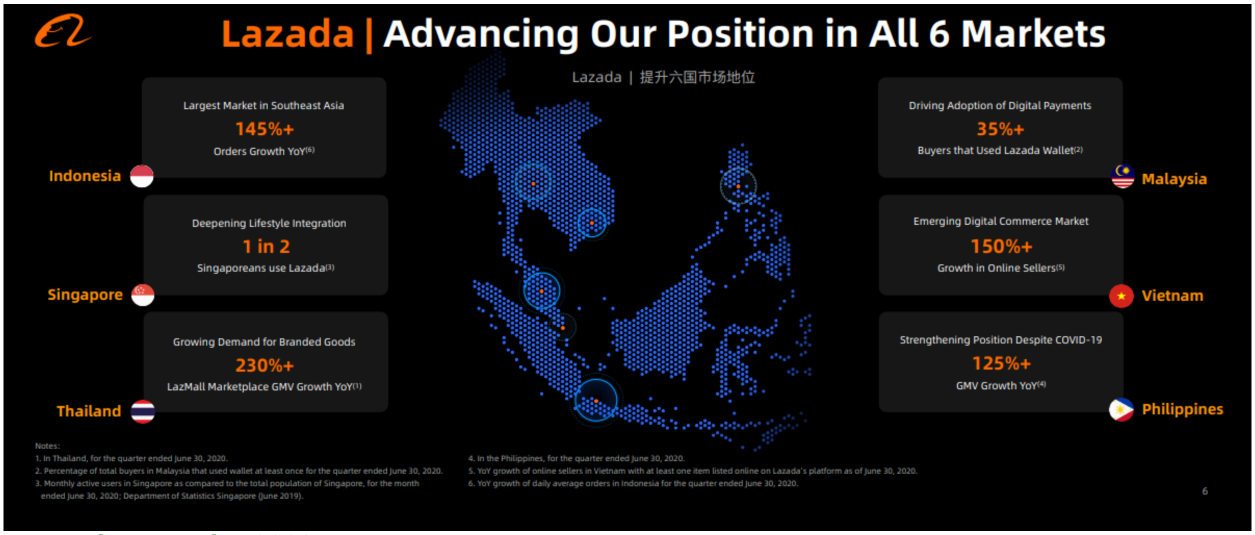


Image: investor day 2020

AliExpress is arguably the most global of Alibaba's offerings, with an online marketplace offered in 17 languages. It has large penetration in Russia and in the United States, where it allows consumers outside of China to access Chinese goods. Revenue from both of these international operations has grown by 28% since last year, primarily due to Lazada. AliExpress decreased sales over the same period, which management explained as a consequence of deconsolidation in Russian operations.

Logistics and Cloud computing

Alibaba operates Cainiao logistics and its cloud computing network. Its cloud computer network operates similar to Amazon Web Services, offering multiple networking and cloud infrastructure services. They boasted a cloud computing revenue up 62% YoY, and over 60% of companies that are listed in China use Alibaba's cloud services.

Cainiao's logistics revenue has grown 49% though it is not yet profitable. Cainiao is Alibaba's network of logistics and warehouse operators, as well as delivery personnel. Cainiao is different from a traditional logistics firm in that they offer standalone supply chain management services, allowing businesses to select how much of the service they wish to use. Cainiao includes a global freight network, allowing cross-border business-to-business trade to be facilitated.

We expect both Cainiao and Alibaba's cloud services to be profitable by 2021.

Wholesale Commerce

Alibaba operates 1688.com domestically and Alibaba.com globally. These are business-to-business operations, in which consumer goods manufacturers are connected to retailers digitally. This benefits smaller retailers by expanding their offerings to include large wholesale manufacturers. All benefit: enhancing value for the manufacturer, retailer, down to the individual customer. Internationally, this had a revenue increase of 43%, domestically this had a revenue increase of 13%.

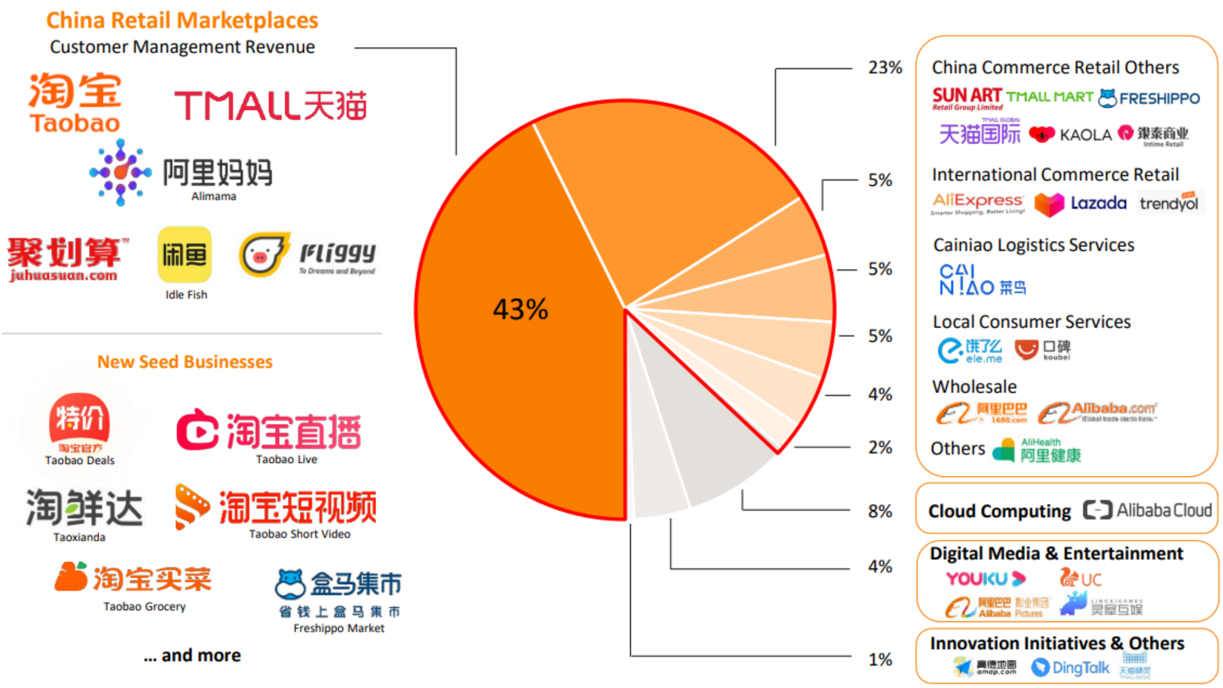


image: Q1 2021 presentation.

Risks

Investing in a company based in China has significant political risks as a communist authoritarian regime often makes harsh and arbitrary decisions regarding the economy and private sector. For example, in Q4 2020 the Chinese government suddenly leveraged a massive $2.8 billion fine on

Alibaba, as they claimed it violated the anti-monopoly law – but was not specific in terms. This unexpected fine drove Alibaba's Q4 FY2020 results into the net negative, though for FY2020 they were still far into the positive.

Foreigners investing in certain classifications of Chinese companies – such as internet companies – are not legally allowed to own the shares directly. Thus, they use a complex system of financial vehicles shell companies, to get around this restriction. Should the Chinese government clampdown on this, it could result in heavy losses. This already occurred, when the Chinese supreme court ruled those certain measures to avoid ownership restrictions, if they provide voting rights to foreigners, are illegal.

There is also the further risk of tariffs. While much of Alibaba's revenue is domestically Chinese (>65%), there is still a significant market within the United States and Europe, and other countries that may wish to impose sanctions on China (~8%).

The risk of Chinese stocks seeing a capital flight is possible, should an exchange choose to delist more Chinese stocks, or should the United States impose capital controls on US investors investing in Chinese companies.

The risk of further escalation between the US and China is difficult to calibrate but could be catastrophic to investors in BABA. Nationalism can result in emotional decisions that are not optimum for either party. These risks cannot be dismissed and are at least partially reflected in BABA's valuation compared to its financial metrics and similar companies.

Metrics

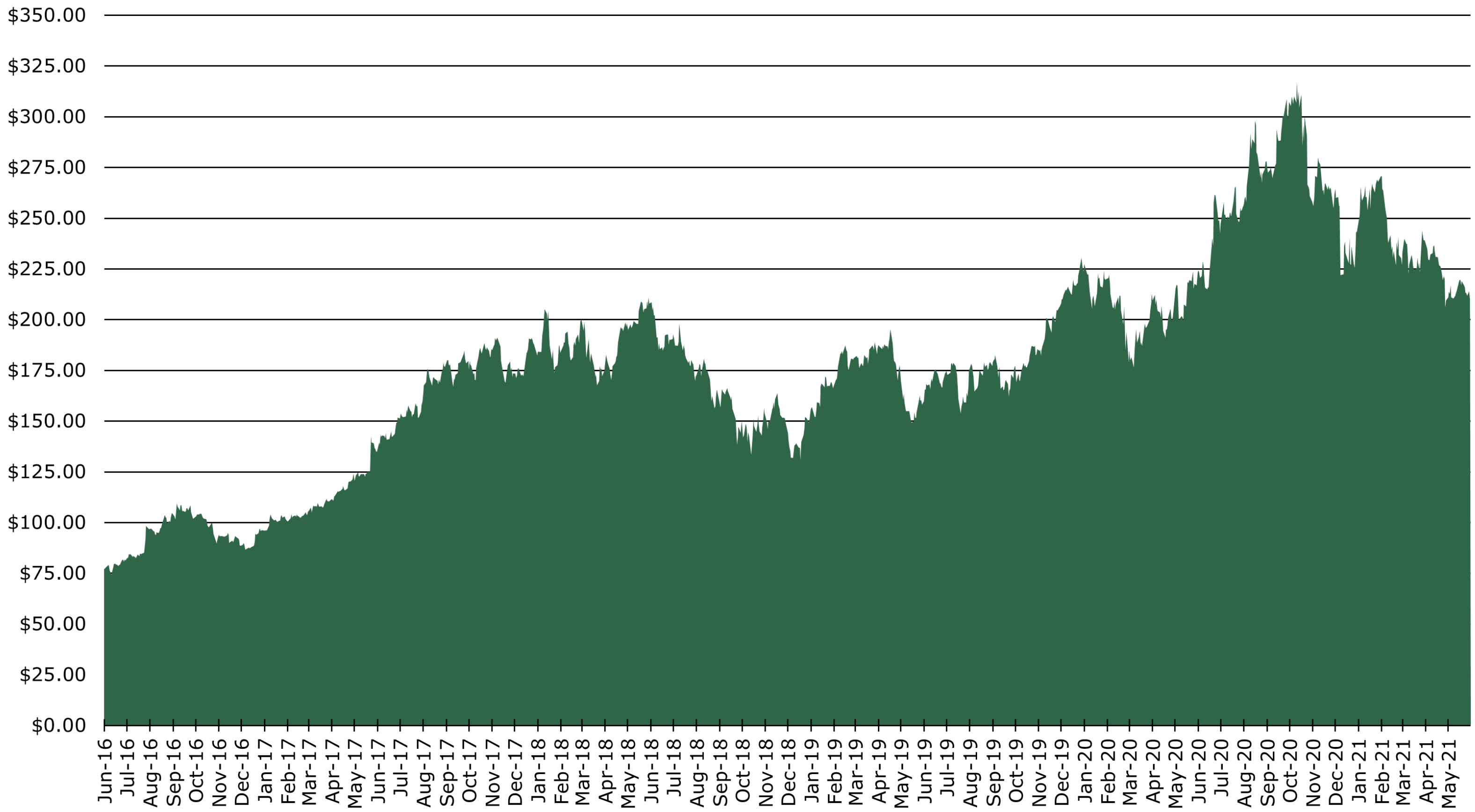
Trailing 12 months	Amazon	JD.com	MercadoLibre	Ebay	Alibaba
Price-to-Earnings	64.99	99.8	3048.8	17.8	33.2
Price-to-Sales	4.1	0.9	14.9	4.0	5.07
Market Cap (Billions $)	1,710.0	110.4	70.0	44.9	569.5
Sales (Billions $)	419.3	118.6	4.7	11.4	106.1
Net Profit Margin	6.42%	0.99%	0.54%	23%	15.47%

The relative valuations are hard to compare as revenue recognition is different by company, thus skewing price to sales and net profit margins. From the price-to-earnings, we can see Alibaba has a very favorable ratio, compared to its competitors.

We believe that Alibaba Group has fantastic growth potential from a fundamental standpoint and that this outweighs the risk it faces.

Alibaba Group	E2021	E2022	E2023
Price-to-Sales	5.375	3.892	3.217
Price-to-Earnings	21.0	16.8	14.5
EV/EBITDA	27	16	13

Alibaba Group (BABA)



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