Case Study:
Alibaba Group (BABA)
NYSE

Presented by James Xinye Zhang | October 21st, 2014
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Alibaba?
• Alibaba Group started out as a small online retailer.
• Various mergers and strategic deals enabled the company to dominate e-commerce in China
• Evolution into unique company
  - ecosystem rather than service
Prior Growth

- Rise of e-commerce in China helped spur the company’s growth
- Chinese middle class begins spending more money, more consumption
- 79% of Chinese e-commerce market
Primary Business Components

- Taobao
- Tmall
- Alipay
- Alibaba Cloud Computing
- Cainiao
- AliExpress
Alibaba doesn't directly compete with merchants; works with them and provides a platform for dual profits. Leads to profitability and strong cash flows.

- Seeks to innovate and thrive
- No specialty in one area; create online ecosystem rather than focus on niche
• Revenue growth- still outpaces Amazon’s. The U.S. online retailer reported a 23% jump in third-quarter revenue to $19.34 billion, just about half of Alibaba’s pace of expansion.

• Size- In 2012, the combined transaction volume of Taobao and Tmall topped one trillion yuan ($163 billion) - more than Amazon and eBay combined.”

• Profitability- Alibaba profit totaled $2.8 billion for the nine months ended Dec. 31 on revenue of $6.5 billion. - A penny for every dollar in revenue vs 43 cents.
Unlike Amazon, which buys goods from suppliers and sells them to customers, Alibaba has always acted as a middleman, connecting buyers and sellers and facilitating transactions between them.

Merchants don't pay to sell products on Taobao. Instead, they pay Alibaba for advertising and other services to allow them to stand out from the crowd.
VAST NETWORK

- Collective entrepreneurship - Alibaba provides platform, merchants provide products.
- Revenue sharing simplifies business; makes it easier for additional merchants to join network.
- Larger network - greater benefits and thus attracts more customers
Chinese Consumer Growth

- China is changing from manufacturing-oriented to consumption-driven economy
- Huge increase in white collared middle class
- “Our business benefits from the rising spending power of Chinese consumers”
  - Alibaba SEC Prospectus
E-Commerce development in China

- Smartphone access grants online accessibility to everyone, of all ages and demographics
- Leapfrogging
- E-commerce in China does not just occur in urban regions.
  - Citizens in rural and interior regions now have access to online services
• Comparable to eBay
• China’s largest e-commerce website
• Features thousands of non-brand name products sold by smaller-unknown merchants
• **Assumption Driver**: increase in consumption of high end consumer goods

• Tmall’s “LuxCity” provides platform for world renowned luxury brands to cater legitimate products to Chinese consumers.
ALIBABA’S ECOSYSTEMS

- Entertainment
- Alipay
- Guangzhou Evergrande FC
- Investment in small US companies.
  - Vendio Services Inc. and Auctiva
  - ShopRunner
  - Quixey
  - TangoMe Inc.
WHERE DOES ALIBABA’S REVENUE COME FROM?

- Chart from Seeking Alpha

Alibaba 2014 revenue breakdown

- China commerce retail business
- China commerce wholesale business
- International commerce retail business
- International commerce wholesale business
- Cloud computing and Internet infrastructure
- Others
Alibaba has made around $4 billion in entertainment investments.
- The company will benefit greatly from Chinese cinema market.

China’s box office projected to increase from $3.13bn in 2013 to $5.9bn by 2018.

Chinese demand for films, both domestic and Western (Hollywood) will spur revenues in entertainment.
Lionsgate Entertainment World to stream Hollywood movies and television in China

“We are committed to expanding our ecosystem where our users can meet, work and live,”
- Patrick Liu, president of Alibaba Group’s digital entertainment business
• $804 million investment, 60 percent controlling stake in the company

• Main distributor in Journey to the West: Conquering the Demon, 1.25 billion yuan revenue.
**ChinaVision Media’s Multiple Segments**

1. Producing and distributing film rights, television programs and dramas

2. ChinaVision distributes the most popular morning newspaper in Beijing, the Beijing Times

3. Mobile handset devices, and develops and distributes Mobile TV

Alibaba is not only buying mobile tech company, but exposure to news media, television, and the continued rise of Chinese film market
• Alibaba Group acquired a 20% stake in Wasu Media, $1.05 billion, collaborate in online content and Internet TV.

• Support in original content development, video communication, games, music, education, cloud computing, big data

• The companies collaborated last year in co-launching television set-top box
  - Set up box connecting businesses
Online video market in China

Percentage of internet users who watch online video content on any device in 2014, by country

- South Korea: 95.9%
- Spain: 92%
- Italy: 91%
- Mexico: 90.1%
- China: 89.6%
- Canada: 84.8%
- Argentina: 84.4%
- India: 84.1%
- United Kingdom: 79.9%
- United States: 78.4%
- Australia: 77.4%
- Brazil: 77.3%
- France: 75.1%
- Japan: 73.6%
- Germany: 71%

Statista.com
Producer, entertainment industry consultant

China’s film industry is expanding at around 4x its GDP growth

“The Chinese population has embraced movies, both foreign and increasingly domestically made Chinese movies, with exuberance.”
Projected Box Office, China vs. N. America

- N. America
- China

B.O. $ US bil.

• B2B
• Connects Chinese manufacturers with foreign buyers
• Negotiate order; no shopping cart
• “Made to order” rather than advertise ready-made products
• High MOQ
• B2B and B2C
• Portal to link Chinese trading companies with foreign buyers
• Smaller “ready-made” items, aimed at smaller companies
• MOQ is usually 10+ items
Ecosystems- Alipay and Online Banking

- Zhejiang Ant Financial Services Group- vital in Alibaba’s push to further financial operations for small consumers and merchants online.
- Alipay- Subsidiary of Zhejiang Ant, is online 3rd party payment platform. Most of Alibaba e-commerce transactions go through Alipay.
- Started in 2004, now has 190 million active users, online transactions worth $660 billion.
- Alipay Wallet- mobile electronic pay system
AliPay restructuring

• Restructured Alibaba’s loan business to Small and Micro Financial Services Company. Gives Alibaba smaller exposure to financial services while gaining potential to profit from such micro-financing businesses.
Banking in China

- China still has a huge financial system that rather limits middle class opportunities in investments
- Traditional financial system is rigid and concentrated in state institutions, but changing rapidly
- Can Alibaba use technology to give more exposure to the middle class?
• Alibaba wants to provide full range of online transactions w/o physical banking.
• will soon apply to create a micro-loans and micro-savings private bank.
• This “will fully leverage technology as well as big data analysis to better serve grass-root individual consumers and small and medium enterprises”
  - Yu Shengfa, VP of Zhejiang Ant
• The new private bank will cater more to consumers and small businesses
• Use transaction data online to examine customer credit
• State-owned banks and institutions underserve such customers
• Alibaba will achieve synergy through its own industry platforms
“Digital penetration is happening faster than people would imagine in China. More and more elderly people are getting used to digital channels—even my mother-in-law [uses] online banking and WeChat.”

- Zhang Yue, project leader at Boston Consulting Group, Shanghai. “
Yu’e Bao Fund

• Yu’e Bao (余额宝) is an investment product offered by Alipay.com.
  -managed by Tianhong Asset Management

• Alipay users deposit money into Yu’e bao, invests in funds (4.2% versus 3.3% - one year deposit)

• Growing trend of depositors transferring money away from banks and into internet money market funds.
A Rising Tide
Money market funds are enjoying a surge of popularity among Chinese investors.

- **Assumption Driver**—as money market funds become more popular, Yu’e Bao will grow with tremendous potential in the near future.
• 90% of the funds’ deposits invested in interbank deposits

• Investment is relatively safe, as long as the state-owned banks do not default on loans they exercised from Tianhong, which should not occur.

• Yield could be sustainable, but the 6% is “not the norm”
Yu’E Bao

享受14倍*银行活期收益

支付宝打造的余额理财服务
通过余额宝，用户不仅能够得到收益，还能随时消费支付和转账，像使用支付宝余额一样方便。首期支持天弘基金增利宝货币基金。

每日惊喜
余额宝资金用于投资国债、银行存单等安全性高、收益稳定的金融工具，收益率较高，收益每天发放。

安全保障
支付宝为您提供资金保障服务，资金被盗全额补偿，万无一失。

*数据来源：天弘基金，余额宝上线到3/11/18，风险不同于银行存款。

2014年02月09日
余额宝收益播报
6.1740% 七日年化收益率
马上体验余额宝
“We allocate investments and match maturities based on data analysis. At different stages a bank's ability to take deposits varies. On one hand, there are banks that can only take, say, 10 billion yuan, but we have 11 billion yuan that needs to be taken care of. That is when we hit the limit of their deposit-taking ability. We can deal with other banks or lower the interest rates we charge. On the other hand, a larger size brings greater negotiating power. We can ask for higher interest rates.”

- Wang Dengfeng (oversees money market fund connected with Yu’e Bao)
• The Chinese government is receptive to the idea of internet banking
• In “state of the union” address, Premier Li Keqiang promised to deliver and “promote the healthy development of internet banking.”
• BUT, expect some changes in regulators’ supervision
• Primarily serves Alibaba’s e-commerce and internal businesses such as AliPay
• Provides technology and supports online services for businesses
• 2013; Processed 14.5 billion order exchanges from 70,000 merchants and 279 million online consumers
“The services of AliYun are similar to the services of public electric power networks. Without these public utilities, you may have to spend lots of money on buying a generator for making electricity. Our cloud services enable our clients to only pay for their present demand and save on initial investments, just like we use electricity today.”

-Alibaba Cloud Computing
• Alibaba planning to start operating its cloud business globally, AliYun
• AliYun collects revenue from companies and clients that use its data centers and computing resources
"We will continue to implement our data strategy through the application of data intelligence and deep learning technologies to several fields, including marketplace design, user interface, search, targeted marketing, logistics, location-based services and financial services, among others."

-SEC Prospectus
• Distributed computing infrastructure
• Serves its own platform, Alipay, and subsidiaries
• Provides cloud computing services to sellers

*Cloud Computing Cafe
• Engineered by Alibaba Cloud Computing
• Linux based operating system
**OS FEATURES**

- Fully functioning with cloud
  - 100 GB in storage space (free)
  - Ability to stream apps from web instead of storing in phone memory.
  - Mostly designed to run cloud applications in own ecosystems

AliYun OS is open-source based OS
• Alibaba has made forays into the U.S. market
  - Vendio Services Inc. and Auctiva
  - ShopRunner
  - Quixey
  - TangoMe Inc.
• Alibaba can match 80,000 small businesses in the U.S with supplier sourcing via Alibaba’s platforms.

• More effective sourcing- allows AliExpress to utilize Vendio platform for selling across multiple marketplaces
• “Acquisition will help provide tools and resources for U.S. small businesses looking to leverage e-commerce.”
• Retail website investment allows Alibaba to enter U.S. marker
• “Trojan Horse” to Amazon
• Extremely popular messaging app
  ➢ Free video calls
  ➢ Miniature ecosystem
  ➢ Become increasingly broad - creating platform for TangoMe users to engage in activities such as texting, gaming, photo-sharing

• Alibaba can expand into U.S. mobile phone platform
• Why does Alibaba seem to sprawl its investments in so many companies?
**STOCK METRICS**

- **High growth stock**
  - Earnings is extremely important
- **Alibaba could grow 40% in 2015, 30% in 2016**
- **58.5% EBIDTA margin in 2014**
- **High P/E Ratio**
GROWTH COMPANY VALUATION

- **Classic Growth Company** - Creates new product, establishes demand due to technology/innovation
- **Market Share Growth Company** - Mature industry, rapid growth due to increasing market share via product quality, brand name, or service
- **Consolidator** - Fragmented industry, grows inorganically through multiple acquisitions and taking advantage of synergies.
## Comparable Multiples

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<th>BABA</th>
<th>AMZN</th>
<th>EBAY</th>
<th>BIDU</th>
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<tr>
<td>EV/EBITDA</td>
<td>44.68</td>
<td>33.7</td>
<td>11.44</td>
<td>28.11</td>
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<tr>
<td>EV/Revenue</td>
<td>23.13</td>
<td>1.66</td>
<td>3.24</td>
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<tr>
<td>EPS</td>
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<td>0.39</td>
<td>-0.10</td>
<td>5.54</td>
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<tr>
<td>P/E Ratio</td>
<td>37.73</td>
<td>158.97</td>
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<td>Price/Sales</td>
<td>23.33</td>
<td>1.71</td>
<td>3.40</td>
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<td>Price/Book</td>
<td>22.24</td>
<td>13.2</td>
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Does earnings reflect long term trend or is it a temporary occurrence?
Future Stock Growth

• Strong brand, enormous scale, rapidly increasing impact of ecosystem
• Growth and margins should justify high valuation
• How will high revenue growth translate into stock performance
American Depository Shares

• “US dollar-denominated equity share of foreign company for purchase on American stock exchange”
• Investors do not own common shares, but claims to foreign shares.
• Not buying a piece of the company
• Shareholders have almost no say in how the company will be run
WHAT ARE INVESTORS BUYING?

• Investors purchasing shares of Alibaba in offshore, Cayman Islands entity
  ➢ Alibaba Group Holding Limited

  ▪ Plot twist!

      ......The entity doesn’t actually own Alibaba......
• Alibaba conducts business via complex investment vehicles.
• Allows the company to have offshore entities, used to accept foreign investors’ money
• Complications may arise
• Convoluted ownership structure
• A labyrinth of partnerships, subsidiaries, offshore vehicles.
• Controlling partnership of Alibaba have most power
  ➢ 27 partners effectively control the Alibaba’s board
  ➢ small group make decisions regarding the entire company without much outside input.
Exposure to Risks in China

- Alibaba can be impacted by economic slowdown
- May be subject to future anti-monopoly laws
  - Enforcement action against abusive market dominance and heavy fines
- Potential consequences of government perception against Alibaba
FUTURE PLANS

• Increase active buyers and wallet share
• Expand categories and offerings
• Extend mobile leadership
• Enhance success of sellers
• Enhance data and cloud computing
• Develop cross-border commerce opportunities
CONCLUSION

• Alibaba; Silk Road 2.0?
• Misperception that Alibaba is “just like Amazon”
• Ecosystem in various industries; is self-sustaining, various operations of Alibaba support internal systems
• Ideal investment opportunity?
让天下没有难做的生意

To make it easy to do business anywhere