E-Commerce
China

March 14, 2016

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Alibaba Group Holding (BABA US)
Hungry for Cash

Raising Debt

Alibaba has again gone into the debt markets, borrowing USD 3 bln for "general corporate purposes." With cash of more than USD 18 bln and positive cash flow, we question why BABA needs to raise more debt, and why in particular US dollar debt.

The Keiretsu

Ant Financial, the company that manages all of Alibaba's financial transactions, has just closed RMB 20 bln at a roughly RMB 250 bln pre-money valuation. At the same time, China Smart Logistics (Cainiao), the logistics company in which Alibaba is invested and which Jack Ma chairs, is raising money. Directly and indirectly, these raises will benefit Alibaba. We see Alibaba's constant quest for cash as a red flag for a company whose financials show it to be cash-rich.

AliFortune

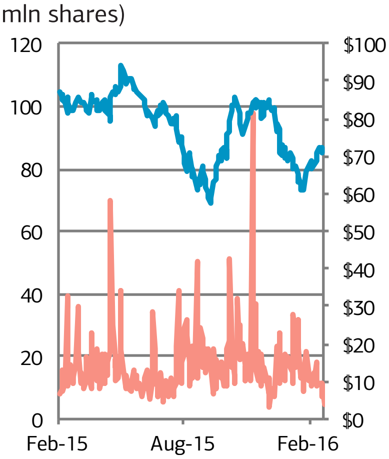
Another acquisitions that will make Alibaba's GMV look higher, but is there any value there?

Reiterate SELL, TP USD 36.58

Alibaba Group Holding (BABA US)

Price	USD 73.37
Rating	**SELL**
Price Target	**USD 36.58**
Difference	50%
Market Cap	USD 183 bln
P/E	17.81

Alibaba (BABA US) last share price in USD (blue) and volume (pink, in mln shares)



Source: Bloomberg

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More Cash, More Debt

Raising U.S. dollar debt makes little sense now.

On March 9, Alibaba disclosed that it had entered into an agreement to borrow USD 3 bln for a five-year term. The disclosure in its entirety reads as follows:

> "Alibaba Group Holding Limited today signed a five-year US$3 billion syndicated loan agreement with a group of eight lead arrangers. The loan, which is subject to upsize through oversubscriptions in syndication, has a five-year bullet maturity and is priced at 110 basis points over LIBOR. The use of proceeds of the loan is for general corporate purposes."

Including redeemable preference shares, as of December 31, Alibaba had USD 18 bln in debt. The new raise brings that to USD 21 bln. Yet Alibaba reported USD 18.266 bln in cash as of December 31 and USD 4 bln in operating cash flows in the fourth calendar quarter. The company spent USD 2.2 bln in investing activities in the quarter, so there's no real need to raise cash.

In other words, Alibaba is cash-rich and has announced no major acquisitions that would require heavy spending. The portion of operations that could possibly require heavy capital expenditures is in logistics management, but those functions reside in related-party company China Smart Logistics.

Raising U.S. dollar debt makes little sense now, with depreciation pressure on the Renminbi and very low financing rates available within China. little

Ant

In the meantime, new raises by affiliates Ant Financial and China Smart Logistics will filter back in part to Alibaba.

Ant Financial, the huge shadow financial services firm that includes Alipay and handles all of Alibaba's investment businesses, just completed a round of financing that raised about USD 3 bln, according to the Chinese press, also for general corporate purposes. Press articles say that Ant is being valued at between RMB 200 and 250 bln. Only State-owned enterprises were permitted to participate in the fundraise. The company hopes to IPO on the A-share market in 2017.

Under the Alibaba-Alipay restructuring provisions of 2014, when Ant lists, Alibaba can choose to keep receiving 37.5% of Ant's profit or it can get 37.5% of the IPO funds raised on a one-time basis, provided the raise is over USD USD 2 billion and the valuation is over USD USD 25 billion. So Alibaba stands to receive around USD $1 bln in 2017, should Ant Financial successfully IPO.

The company was established in October 2014 and comprises Alipay, Yuebao (Alibaba's money market sales company), Zhaocaibao (the WMP sales company), an online bank, Sesame Credit, Zhong An Insurance, and other divisions. It has a joint venture with Debang Funds. Participating in this round are the National Social Security Fund, the Postal Savings Bank, the China Development Bank, and several government private equity companies. The PE CDH is raising the round of capital. Investors will invest via a Shanghai industrial fund designated for investment in financial services. Among other things, investing in the fund will obscure equity stakes by individuals who may not want to be named publicly, another Jack Ma signature.

At the end of 2013, Ant Financial's owners were Hangzhou Junhan and Hangzhou Junao with about 58% and 42% respectively. Jack Ma and Simon Xie Shihuang were the limited partners of Junhan and Jack Ma, through a holding company, was the GP of Junao, which names several individual LPs. And yet the document says that Jack Ma's ownership in Ant is not more than his share in Alibaba before IPO, and that was 8.9%. That indicates that despite being the only named LP of one fund and GP of the other, his ownership was 8.9% or less at the time of Alibaba's IPO.

The disclosure gives us the first information about Alibaba's Yu'ebao fund-raising scheme, and the information is confusing. Yu'ebao was established by Alibaba in 2014 to raise money for investment in higher-yield products, principally from Alipay clients. Its ownership sits under Ant Financial. Yu'ebao raises money that is then managed by Tianhong, a fund in which Ant owns controlling equity. Yu'ebao/Tianhong was reported by Sina and others at the end of 2014 to have RMB 589.8 bln under management and is now reported by Baidu to manage RMB 700 bln, a number confirmed by our own interviews. But the news reports on Ant Financial say that there were 44.4 mln depositors in the Yuebao scheme as of September 2014 and they had 33.9 bln RMB on deposit. The contradiction possibly may be explained since Yu'ebao is conceptually a pass-through and may hold money for Tianhong only temporarily.

China Smart

Public information on the China Smart Logistics raise is much less detailed than for Ant. Established in 2013 with investment from Alibaba, the Yintai Group, four logistics companies, and several financial institutions, China Smart has registered capital of RMB 5 bln and an investment plan currently extending to RMB 300 bln. The amount of financing sought has not been made public. China Smart is described as "the world's largest Big Data platform for logistics."

China Smart is advertising that any cross-border e-commerce company coming onto its platform will receive a RMB 100 mln subsidy—for how long, under what conditions, unclear.

So at the very least, Alibaba stands to benefit from these fundraising events in two ways: if Ant Financial lists on the A share market, Alibaba could receive 37.5% of the raise, and Alibaba could get RMB 100 mln from China Smart at least once (depending on whether TMall, Taobao, and other platforms get separate subsidiaries) as a result of somehow using the "platform" for sales of imported goods.

Since Customs issued new regulations in 2014 on e-commerce companies engaging in imports, the companies have been scrambling to establish bonded warehouses and offer more imported products to their customers. The regulations essentially create a loophole that enables e-commerce operators to import products tax-free.

AliFortune's Acquisition

Alibaba used to sell lottery tickets but had to pull back in 2015.

News outlets reported on March 7 that AliFortune, a 60-40% joint venture between BABA and Ant Financial, acquired 59.45% of Hong Kong GEM-listed AgTech (8279 HK) for HKD 2.39 bln. AgTech announced the deal but not the name of the acquirer.

AgTech sells point-of-sales machines for lottery tickets in 29 provinces and derives a small minority of revenue from online sports betting games. Alibaba used to sell lottery tickets but had to pull back when in 2015 unauthorized companies were banned from selling lottery tickets online.

Alibaba Sports, a joint venture among BABA, Sina, and Jack Ma's private equity firm Yunfeng Capital, has recently announced a partnership with Oceans Sports and Entertainment to promote the International Federation of Poker's Match Poker events in China. Oceans is an OTC sports marketing company based in Beijing.

The deal was done for a HKD 1.68 bln in shares and HKD 712 mln in cash and was conducted at an 85% discount to AgTech's current market price.

Many of Alibaba's deals look more like loans and/or means to generate unverifiable turnover than like strategic investments. The Alibaba Sports venture with Sina and Yunfeng has classic Alibaba characteristics. First, the convoluted investment structure guarantees that results of the venture will be impossible for shareholders to predict or auditors to monitor. Second, Sina's investment in the venture looks suspiciously like payback for Alibaba's 2013 investment in Sina's Weibo (WEI US). And finally, the venture's position in between Sina and Alibaba would make it very easy for the companies to transact with each other while making the transactions look like ticket sales.

Another similar transaction occurred in June 2014, when Alibaba "bought" half of a football team from Evergrande Real Estate Group (3333 HK), and the two companies listed the football team on the Shenzhen exchange the following year, making it the most highly valued soccer club in the world, according to the Wall Street Journal. AgTech shares a few characteristics with Evergrande: at the time of its last report, AgTech was losing money and had current liabilities only slightly lower than its current assets. Done at such a deep discount, the deal would seem to convey a quick infusion of cash to AgTech in return for the right to use machines in 29 provinces to churn cash. Owning AgTech will also allow Alibaba to apply for an online lottery sales license, and there is nothing like the sale of virtual goods to create GMV.

Alibaba also recently contracted with the State oil giant CNPC, according to news reports, to provide mobile payments, mobile services, and online maps. BABA and CNPC have partnered previously to enable CNPC to sell discounted gas cards over BABA's e-commerce channels. Let us observe only that CNPC has plenty of ways to sell discounted gas cards if it chooses to do that. The sale of stored-value cards online is a notorious channel, in any country, for money laundering, gray-market transactions, and the generation of fake GMV.

Insiders

Since mid-October, Alibaba insiders have sold USD 329 mln in shares. The biggest seller has been Dataxchange Development, but that company's ownership is unknown.

Table 1. Insider Sales

Name	Rating	Relation	Date	Type	Shares	Avg. Price	Value
Hu Xiaoming	VP	3/3/16	144 Sale	5,496	$70.86	389,400	
Jianfeng Zhang	Officer	3/3/16	144 Sale	2,547	$70.86	180,500	
Peng Lei		Officer	3/3/16	144 Sale	14,747	$70.86	1,000,000
Kwauk Teh Ming Walt...	Dir	12/15/15	144 Sale	10,000	$82.49	824,900	
Jianfeng Zhang	Officer	12/11/15	144 Sale	74,500	$84.76	6,300,000	
Jiang Peng	Officer	12/11/15	144 Sale	332,833	$84.85	28,200,000	
Peng Lei		Officer	12/10/15	144 Sale	30,000	$84.38	2,500,000
Golden Jade Investm...	Shareholder	12/1/15	144 Sale	500,000	$84.08	42,000,000	
Wu Minzhi (Sophie)	Officer	11/27/15	144 Sale	25,000	$81.71	2,000,000	
Wu Minzhi (Sophie)	Officer	11/27/15	144 Sale	16,792	$81.71	1,400,000	
Nationbright Invest...	Shareholder	11/20/15	144 Sale	1,500,000	$75.85	113,800	
Wang Jian	Officer	11/18/15	144 Sale	290,000	$83.61	24,200,000	
Hu Xiaoming	VP	11/13/15	144 Sale	50,000	$72.65	3,600,000	
Dataxchange Develop...	Shareholder	11/4/15	144 Sale -Planned P	1,680,000	$84.52	142,000,000	
Dataxchange Develop...	Shareholder	8/14/15	144 Sale	1,000,000	$74.71	74,700,000	

Source: EZ-Insider

Valuation

Alibaba would plausibly be able legally to create almost any financial results it wants.

We reiterate our SELL recommendation on Alibaba. Too much of this company's financial transactions occur behind a veil of obscurity involving a plethora of related-party companies and funds. Alibaba would plausibly be able legally to create almost any financial results it chose to. We view that as too risky for institutional investors who manage anything but high-risk money.

Our valuation is built on a P/E multiple of 23, assuming average revenue growth of 25% in each of the coming five years and assuming, based on our calculations, that GMV is overstated by a factor of three.

Risks

Perhaps more than any other, Alibaba's stock trades with U.S. sentiment on the Chinese economy and general liquidity flows internationally. As a result, the stock price has whipsawed up over the last few weeks. A surge to USD 80 or even more is entirely possible.

Correction

On page 9 of our initiation report, we inadvertently repeated an abbreviated and sarcastic version of a comment from a call transcript that had been reported by the blogger Deep Throat IPO. The questioner had asked about GMV, and CEO Daniel Yong Zhang offered a response but seemed to avoid providing the detail asked for. He blamed deceleration of GMV on warm winter weather. But his response was hardly as ridiculous as reported. The response, from the call transcript, was as follows:

> "Thank you. This is Daniel. I will take the first question and I will leave the second to Joe. In terms of Tmall growth, actually, when we look at our big picture, and in this quarter we generated RMB 946 billion (sic) [RMB 964 billion] (20:28) GMV and with net adds of RMB 177 billion compared to the quarter one year ago. So we think this is a huge base and the amount is massive, and we are happy with the result. And we believe that this is very important at this stage and with such a huge scale, we can continue to grow our user base and grow our active – especially our active annual buyers to 407 million.
>
> "And in terms of growth, actually, I have to mention that, actually, when we look at the weather in the Q4, the weather is quite warm and the temperature is unusually high in the Q4, especially in November and December. And what we observed is that the heavier clothing items with higher ASP actually is not selling as well. But we are happy to see that in January, most areas in China and Hong Kong experienced the coldest winter, and we observed that the heaviest clothing items selling quite good, actually, in the past few weeks." (Source: Q3 2016 transcript from Seeking Alpha)

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