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IPO Analysis: Alibaba.com Limited (1688)

Quam (IA) Limited

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Alibaba.com Limited (**1688 HK**; Alibaba), the leading business-to-business (B2B) e-commerce company in the PRC which provides online platforms for SMEs in China and overseas markets, raises around HK\$2,952M (assuming IPO price of HK\$13.50) through the IPO. The proceeds will be used for acquisition (i.e. on companies with complementary products or new technologies) and business development.

Providing B2B marketplace platforms for SMEs, Alibaba enables business buyers and sellers to interact with and identify potential trading partners in a relatively low-cost but effective way. Major revenue of Alibaba comes from the membership fees from the business account from China, US, India and other Asian countries.

HOLD & HIGH RISK: Strong Growth but Demanding Valuation

Revenue and earnings growth of Alibaba appear to be promising given the 1) positive industry outlook (i.e. More PRC SMEs are willing to pay for B2B services), 2) strong competitive advantage of Alibaba (i.e. strong brand & capital resources) as well as 3) strong shareholder background (participation of Yahoo & Softbank). As such, the net profit could rise robustly to RMB 661M (diluted EPS: \$0.135), RMB 1,107M (diluted EPS: \$0.226) and RMB 1,473M (diluted EPS: \$0.309) in FY07, FY08 and FY09 respectively.

Nevertheless, at IPO price of HK\$13.50, the prospective **08 and 09 P/E of Alibaba could be as demanding as 59.8x and 43.7x** respectively. **Prudent investors may opt to avoid the counter given its demanding valuations. Nevertheless, adventurous speculators who can bear very-high risk may subscribe for the IPO.** Exposure should be limited to around **3%** of total portfolio.

Table 1: Official Results

Alibaba	1H07		FY06	2H06	1H06		FY05
(RMB M)	Jun-07		Dec-06	Dec-06	Jun-06		Dec-05

Int'l Revenue	695.4		991.9	560.4	431.5		527.2
PRC Revenue	261.0		372.0	209.8	162.2		211.1
Other Revenue	1.4		0.0	0.0	0.0		0.0

Total Revenue	957.7		1,363.9	770.2	593.6		738.3
Direct Cost	-122.7		-237.6	-128.5	-109.1		-126.5

Gross Profit	835.0		1,126.2	641.7	484.5		611.8
Sales & Marketing	-307.4		-610.2	-311.2	-299.0		-394.0
Product Development	-58.3		-105.5	-58.2	-47.3		-35.7
Admin. Expense	-88.4		-160.0	-100.1	-59.8		-101.1
Other Op. Costs	1.2		17.6	16.8	0.8		14.5

EBIT	382.1		268.2	189.0	79.2		95.5
Net Interest Income	17.7		23.2	12.8	10.3		7.9

EBT	399.8		291.4	201.9	89.5		103.4
Taxation	-104.5		-71.5	-43.2	-28.3		-33.0

Net Profit	295.2		219.9	158.7	61.3		70.5

Gross Margin %	87.19%		82.58%	83.32%	81.62%		82.86%
EBIT Margin %	39.89%		19.67%	24.54%	13.34%		12.94%
Net Margin %	30.82%		16.13%	20.60%	10.32%		9.54%

IPO Information

Total offer:	227.36M shares
Offer Price:	HK\$13.50 per share (top-end of the IPO range)
O/S Shares after IPO:	5,052.36M shares
Prospective 07 PE:	100.2x
Mkt Cap of Iss. Shares:	HK\$68,206.86M
Stock Quote:	1688

Major Shareholder (as a percentage of the enlarged issued shares):

- Alibaba.com Corporation (75.0%); Public (17.0%)

(Note: Yahoo & Softbank indirectly hold 29.3% & 22.0% in the listed company through interest in "Alibaba.com Corporation")

Use of the Proceeds

At an offer price of HK\$13.50 per share, the group will receive net proceeds of HK\$2,952M, of which:

- HK\$1,771M will be used for acquisitions and new business development
- HK\$591M will be used to expand existing businesses in China and overseas.

- HK\$295M will be used to purchase computer development and develop new technologies
- The remaining balance will be used for general working capital purpose.

Rides on Strong Industry Growth & Solid Business Model

Table 2: Operating Figures

	1H07		FY06	2H06	1H06		FY05
International Market							
Gold Supplier Members	22,018		18,682	18,682	15,516		12,192
Int'l Trust Pass	10,959		10,843	10,843	9,730		7,791

Total Paid Members	32,977		29,525	29,525	25,246		19,983
Int'l Revenue (RMB M)	695.4		991.9	560.4	431.5		527.2
Int'l Rev/Member/Mth (RMB) #	3,709		3,317	3,411	3,181		2,796
=====							
PRC Market							
PRC Paid Members	222,576		189,573	189,573	158,073		121,631
PRC Revenue (RMB M)	261.0		372.0	209.8	162.2		211.1
PRC Rev/Member/Mth (RMB) #	211.1		198.2	201.2	193.2		187.0
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Total Revenue (RMB M)	956.4		1,363.9	770.2	593.6		738.3
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As mentioned above, the revenue stream of Alibaba relies on the membership fees from the B2B clients, the business buyers and suppliers who want to find potential trading partners via the e-commerce marketplaces over 24-hours. Fee-paying members can enjoy "priority placement of supplier storefronts", "priority listings in the industry directory" and "advanced search results at Alibaba marketplaces". The marketplaces enable the followings:

- Suppliers can get access to the active global buyer community, and vice versa for buyers
- Suppliers can launch marketing activities to potential buyers at an economical way
- Buyers can get access to high quality and organization information on products and potential sellers.
- Convenient, real-time and "24-hours a day" services for both the buyers and sellers

Table 3: PRC SMEs paying for 3rd-party B2B Platforms

	2005	2006	07(E)	08(E)	09(E)	10(E)	11(E)
SME Number	180K	350K	520K	700K	890K	1,090K	1,300K

CAGR from 2005 to 2011:	39.0%						
CAGR from 2007 to 2011:	25.7%						

Source: iResearch China

Regarding the industry outlook, Table 3 shows that the number of SMEs paying for third-party B2B services is set to grow robustly in the coming 5 years, and the **CAGR between 2007 and 2011 could be around 25.7%**. The growth is driven by the followings:

- 1) Strong economic and business-trade growth in China
- 2) Low penetration rate for the usage of third-party B2B platforms in China, which could just be 28% in 2006
- 3) The increasing popularity of broadband internet usage in China

Worthwhile to note, there is no sizable competitor in China who provides similar B2B e-commerce service, and this may imply strong competitive advantage for Alibaba given its brand and service quality. Strong shareholder background from Yahoo and Softbank could be another buoyant for Alibaba's industry leadership.

Risks

Alibaba is subject to the following risks:

- Any slowdown in PRC economy or global economy may adversely affect the domestic trade and export activities in China, and this may negatively affect the revenue and earnings of Alibaba.
- Potential emergence of sizable competitors, which may negatively affect the business of Alibaba
- Actual industry growth falls below estimates, and actual earnings could miss our estimates

Forecasts & Recommendation

Table 4: Forecast & Valuation

(\$M)	FY06(A)	FY07(E)	FY08(E)	FY09(E)
Revenue	1,363.9	2,123.2	2,994.0	3,858.2
Gross Profit	1,126.2	1,860.7	2,634.7	3,395.2
EBIT	268.2	862.9	1,414.6	1,916.5

Net Profit	219.9	661.2	1,107.1	1,472.8

EPS (\$)	0.044	0.135	0.226	0.309
P/E *	310.1x	100.2x	59.8x	43.7x

* Using share price HK\$13.50; diluted basis

Riding on encouraging industry (i.e. B2B e-commerce platform) growth and its firm industry

position, the revenue of Alibaba is likely to grow robustly in the coming years. On operating leverage effect, net profit growth is likely to outpace the top-line momentum. Net profit could rise robustly to **RMB 661M (diluted EPS: \$0.135)**, **RMB 1,107M (diluted EPS: \$0.226)** and **RMB 1,473M (diluted EPS: \$0.309)** in FY07, FY08 and FY09 respectively (Table 4).

Nevertheless, at IPO price of \$13.50, the prospective **08 and 09 P/E of Alibaba could be as demanding as 59.8x and 43.7x** respectively. We have the **HOLD & HIGH RISK** rating for the counter, and Exposure should be limited to around **3%** of total portfolio. **Prudent investors may opt to avoid the counter given its demanding valuations. Nevertheless, adventurous speculators who can bear very-high risk may subscribe for the IPO.**

Disclosure : CHENG Kwan Lun (AJD 750) , the author(s) of this document declare(s) that as at the date of the publication of this report, he/she/they doesn't (don't) hold an interest in 1688 .

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