Written by

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Marketplace
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Symbol	Price	% Chg
AMZN	3,316.14	0.22%
BABA	232.32	1.30%
CGNT	24.38	-4.09%
CHD	88.85	-0.87%
CHTR	656.23	-0.22%
DG	213.82	-0.62%
FB	298.67	0.73%
GILD	65.06	-0.89%
GOOGL	2,268.71	0.72%

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Alibaba: The End Hasn't Come

Apr. 23, 2021 8:15 AM ET | **Alibaba Group Holding Limited (BABA), BABAF** | 21 Comments | 12 Likes

Summary

- Alibaba's shares are down a lot from last year's highs, as a reaction to the market worrying about a range of issues.
- None of them seems to be too material, though, and the fear that has gripped the market has resulted in a quite inexpensive valuation.
- Alibaba is a high-growth mega-corp that trades like a low-growth company. This provides considerable upside potential in the long run.
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Alibaba Group
阿里巴巴集团

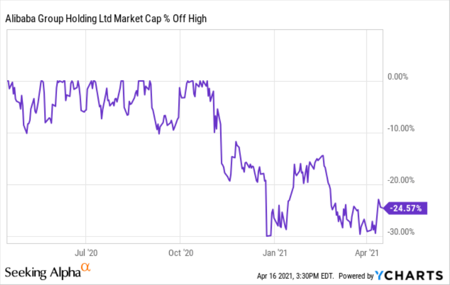
Photo by Andrew Burton/Getty Images News via Getty Images

Article Thesis

Alibaba (NYSE:BABA) has widely underperformed the broad market and most of its tech peers over the last six months, mainly due to worries about regulatory pressures, anti-trust legalization, etc. Most of those issues have been resolved now, and it looks like Alibaba's value wasn't really damaged to a large degree. Alibaba remains a leading tech & consumer play in high-growth China that continues to trade at a clear discount compared to most US-based tech peers. There are risks, but Alibaba seems attractive at current prices.

Hundreds Of Billions Destroyed

Looking at Alibaba's market capitalization over the last year, there is a very clear decline in how the market values the company over time:



Data by YCharts

From a peak in fall 2020, Alibaba's market cap has declined by 25% or a little more than $200 billion to date. The reasoning for that is not based on any type

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Related Stocks

Symbol	Last Price	% Chg
BABA Alibaba Group Holding Limited	232.49	1.37%
PDD Pinduoduo Inc.	139.12	4.35%
JD JD.com, Inc.	77.61	1.97%
MELI MercadoLibre, Inc.	1,590.05	1.70%
EBAY eBay Inc.	60.76	0.03%

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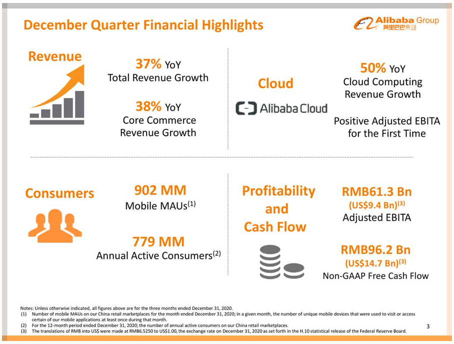
of fundamental slow-down, revenue decline, or similar, showcased by Alibaba's excellent results during the most recent quarters:



December Quarter Financial Highlights

Alibaba Group
阿里巴巴集团

Revenue

37% YoY
Total Revenue Growth

38% YoY
Core Commerce
Revenue Growth

Cloud

Alibaba Cloud

50% YoY
Cloud Computing
Revenue Growth

Positive Adjusted EBITA
for the First Time

Consumers

902 MM
Mobile MAUs(1)

779 MM
Annual Active Consumers(2)

Profitability and Cash Flow

RMB61.3 Bn
(US$9.4 Bn)(3)
Adjusted EBITA

RMB96.2 Bn
(US$14.7 Bn)(3)
Non-GAAP Free Cash Flow

Notes: Unless otherwise indicated, all figures above are for the three months ended December 31, 2020.
(1) Number of mobile MAUs on our China retail marketplaces for the month ended December 31, 2020; in a given month, the number of unique mobile devices that were used to visit or access certain of our mobile applications at least once during that month.
(2) For the 12-month period ended December 31, 2020; the number of annual active consumers on our China retail marketplaces.
(3) The translations of RMB into US$ were made at RMB6.5250 to US$1.00, the exchange rate on December 31, 2020 as set forth in the H.10 statistical release of the Federal Reserve Board.

3

Source: Investor presentation

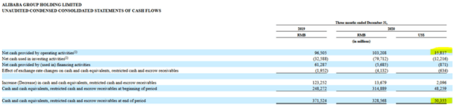
Not only has Alibaba continued to deliver revenue growth of well above 30% since then, but the company also continued to make progress in attractive high-growth spaces such as cloud computing. Alibaba's cloud unit broke even for the first time since inception as its scale is increasing, which bodes well for the future bottom-line contribution of this unit. Last but not least, Alibaba's free cash flow generation remained strong, and its margins remained attractive.

Thus the big drop in the value the market ascribes to Alibaba's shares must have been caused by something else, which is market sentiment and psychology. Some negative news around Ant Financial's postponed IPO made the market fear looming regulatory pressures on Alibaba. This was exacerbated by anti-trust and anti-monopoly investigations. These were, of course, negatives, but not to the extent that the market priced them in.

Looking at Alibaba's market capitalization, which declined by more than $200 billion over the last six months, one could assume that regulators would look to impose a fine of dozens or even hundreds of billions of dollars on Alibaba. That was, however, not the outcome of the investigations.

Things Are Clearing Up For Alibaba

Instead, Chinese regulators gave a slap on the wrist, seeking a $2.75 billion fine from Alibaba. That sounds like a lot, but it really isn't all that much when we consider Alibaba's immense size:



ALIBABA GROUP HOLDING LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended December 31,		
	2019	2020	
	RMB	RMB	US$
		(in millions)	
Net cash provided by operating activities(1)	96,505	103,208	15,817
Net cash used in investing activities(1)	(32,588)	(79,712)	(12,216)
Net cash provided by (used in) financing activities	61,287	(5,685)	(871)
Effect of exchange rate changes on cash and cash equivalents, restricted cash and escrow receivables	(1,952)	(4,132)	(634)
Increase (Decrease) in cash and cash equivalents, restricted cash and escrow receivables	123,252	13,679	2,096
Cash and cash equivalents, restricted cash and escrow receivables at beginning of period	248,272	314,889	48,259
Cash and cash equivalents, restricted cash and escrow receivables at end of period	371,524	328,568	50,355

Source: Alibaba filing

Alibaba generated cash of $15.8 billion through its operations during the most recent quarter, or a little over $5 billion a month. The fine that was imposed on the company thus is equal to about two weeks' worth of cash flows. Is that a positive? No, it's a negative. Is it a large negative? In fact, it seems barely noticeable compared to Alibaba's size. We can also look at how this fine compares to Alibaba's cash holding of more than $50 billion, and, once again, we are talking about a very minor fine relative to how the company is doing. What could be a company-breaking fine for any mid-sized business will barely leave a dent in Alibaba's cash holding, and with this issue being resolved now, it is no wonder that shares have jumped following the ruling.

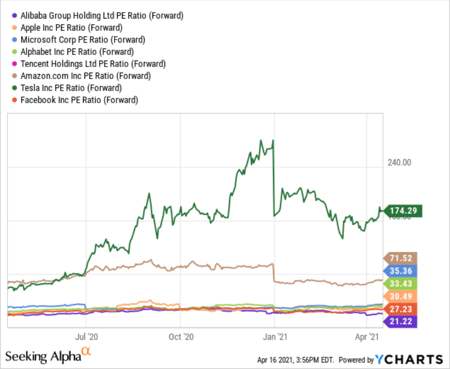
The other theme that had pressured Alibaba's shares, Ant Financial's regulatory issues, has more or less been resolved as well. Ant Financial will be turned into a financial holding company, there will be some additional oversight, and there were some forced divestments. But this didn't break Ant Financial at all, and it seems questionable whether the hit to Alibaba's value was really all that material, as Alibaba is only a minority holder in Ant Financial anyways.

Again, these developments that occurred over the last six months aren't positives, but they are not extremely large negatives. A $200+ billion drop in Alibaba's market capitalization seemed way overblown. The good thing about market overreactions, however, is that one can use them to get attractive entry prices (in case markets are overreacting to the downside) or attractive exit prices (in cases where markets are too exuberant).

In Alibaba's case, the best time to load up on shares was when they traded for around $220 several times over the last six months. They have risen to a somewhat higher level since then, partially due to the market's realization that the $2.75 billion fine wasn't all that material, but Alibaba's shares are still looking quite inexpensive even now.

Alibaba Is An Outstanding Value Among Tech Mega-Caps

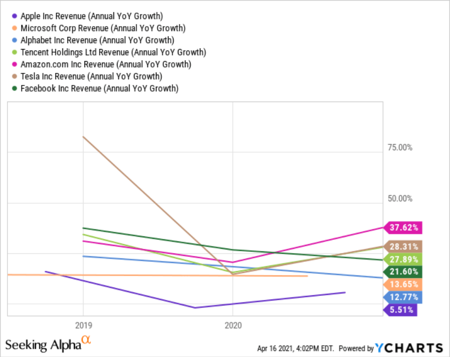
Looking at the largest companies in the world, by market capitalization, we see that most of them are tech companies, or at least tech-leaning, such as Tesla (TSLA). Alibaba stands out among those due to a quite low valuation:



Data by YCharts

While others trade at 30-40 times net earnings mostly, with Amazon (AMZN) and especially Tesla trading at even higher valuations, Alibaba is valued at a very inexpensive 21 times forward earnings. This also represents a discount compared to broad US equity markets, which are trading for around 25 times forward earnings right now - at least partially due to the heavy weight of companies such as Apple (AAPL), Amazon, and Tesla.

One may be inclined to conclude that Alibaba is trading at the lowest valuation among those companies due to a below-average growth outlook or below-average fundamentals, but that isn't true.



Data by YCharts

While the other mega-caps have grown by 5%-40% in 2020, with an average of around 20%, Alibaba has delivered revenue growth of 35%-50% in each quarter of the current fiscal year. Clearly, Alibaba is growing faster than the average mega-cap, and most analysts expect that this will not change any time soon.

Thanks to exposure to the high-growth, online-focused consumer market in its home country China, combined with excellent growth in additional franchises such as its cloud computing unit, Alibaba should be able to deliver compelling growth for the foreseeable future. Alibaba is an excellent play for the ongoing expansion of the Chinese economy, which just delivered record growth on a year-over-year basis.

With a clean balance sheet thanks to a $50+ billion cash position, strong free cash flows, and attractive margins, Alibaba also seems like a very appropriate choice from a quality perspective. To me, the company doesn't look inferior to the major US tech companies on that basis.

Risks To Consider

There are, of course, still risks that one should consider before investing. It is possible that regulators demand more change from Alibaba, or impose additional fines, although that seems relatively unlikely for now as the current anti-monopoly investigation has just been concluded. Nevertheless, Alibaba is of course dependent to some degree on the goodwill of Chinese regulators and politicians.

On top of that, due to a consumer-focused business model, Alibaba would seem quite vulnerable to any external shock that hits Chinese consumers hard. Since the country has weathered the current pandemic quite well and continues to deliver above-average economic growth rates, I don't think this is a likely scenario in the foreseeable future, though.

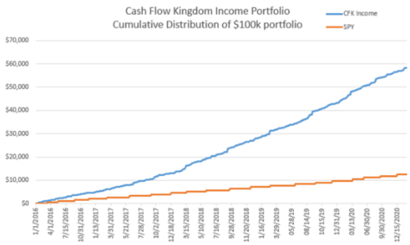
I don't see Alibaba as an especially risky investment at all, but these factors should still be considered before making an investment, as should other potential risks that could affect the company. One should mention, however, that the top US companies are also, at least to some extent, dependent on regulatory goodwill and could see an impact from an economic downturn, thus Alibaba is not necessarily a much riskier choice than Facebook, for example.

Takeaway

Alibaba is a high-growth player with a strong market position in a country that continues to deliver above-average economic growth. Alibaba has strong fundamentals, and yet it trades at a quite inexpensive valuation, both on an absolute basis as well as compared to how other mega-caps are valued.

Alibaba isn't a risk-less stock, but the risks seem quite bearable to me. At just 17 times 2022's net earnings, Alibaba looks attractive to me. Since the Ant Financial and anti-monopoly issues have cleared up, I believe that Alibaba's shares could rise considerably from the current level, as sentiment hopefully improves. It would be great to see management encourage such an upward move by being more aggressive with share repurchases, but there is no guarantee for that.

Is This an Income Stream Which Induces Fear?



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Disclosure: I am/we are long BABA. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

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yet, Munger sees BABA as cash equivalent. I'm long BTW.

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Bronxy Today, 9:03 AM

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I bought BABA at the IPO and will continue to stay long. Agree with you 100%

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Keep buying for the long term and will be fine

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> Author's Reply @Alin11
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>
> Reply Like

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>
> @Alin11 will be fine... more fines? :P *(edited)*
>
> Reply Like

drV_540 Today, 8:37 AM

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I agree fully with your analysis. Sometimes investing is simple . Simply do what is obvious. Consider buying Alibaba when Mr Market is depressed about the prospects . When Mr Market clears its head and cleans its rose coloured glasses , the opportunity will have passed

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>
> Glad we agree! Happy investing!
>
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Investinyourself62 Today, 8:34 AM

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Thanks for the article. What about the potential delisting risks (from the US exchanges)? Should that not be a concern for investors?

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Author's Reply @Investinyourself62

Glad you liked it! I don't see this as very likely tbh

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---

kevinconnolly Today, 8:29 AM

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The real star in China is Pony Ma-------not Jack Ma-------flying under the radar is always a good thing------especially when you portray yourself as a good guy------BUT the reality is you are just another greedy dude------which the Chinese leadership picked up on and slapped Mr Ma back to reality. And yes still bullish on BABA!!!!

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It's has long been buried.

Forget Chinese stocks.. it's a losing bet.

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@Jonathan Weber geopolitics and transparency issues with chinese companies..

It'll be the first to let go, especially with uncertainty in the market..

It's cheap for reason..

Opportunity to buy baba at $175

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Ace-Ventura Today, 9:04 AM

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@Daytrader77 not sure this applies to baba. There are a lot of other smaller Chinese names that may not adhere to accounting standards.

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dmzporter Today, 8:17 AM

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I just keep buying more baba... I cannot help myself

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Jonathan Weber Today, 8:44 AM

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Author's Reply @dmzporter

Haha, thanks for sharing!

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