Alibaba Group

Jack Ma, Alibaba's once high flying founder was so confident in the success of his company that he filmed Alibaba's first meeting in his apartment in 1999, so as to document the moment for the company's later history. Now Alibaba is a leading global e-commerce business, aiming to serve two billion customers by 2036. Alibaba's suite of businesses covers an enormous segment of the Chinese economy, including domestic e-commerce, logistics, international e-commerce, digital banking and payment solutions, cloud computing and digital media and entertainment. However, Alibaba's true advantages lie in its ecosystem: a community of (businesses and consumers) interacting with one another and the digital environment. In the 2000's Alibaba's ecosystem was relatively simple, linking buyers and sellers of goods. As technology advanced, and more business functions moved online the ecosystem expanded to accommodate new innovations, creating new types of online businesses, completely reinventing China's retail sector. Alibaba today is not just an online commerce company. It is what you get if you take all functions associated with retail and coordinate them online into a sprawling, data-driven network of sellers, marketers, service providers, logistics companies, and manufacturers. In other words, Alibaba does what Amazon, eBay, PayPal, Google, FedEx, wholesalers, and a good portion of manufacturers do in the United States, with a healthy helping of financial services to boot.

But Alibaba's outlook today is far from certain. Since October 2020, Alibaba has lost ~60% of its market value, as the company has been subjected to unprecedented regulatory scrutiny and stiffening competition. Today, one of the largest holdings in the Elevation Capital Global Shares Fund, we trust this report will shed light on Alibaba and why we believe the market has mispriced its future potential.

A Brief History of Alibaba

1999 Alibaba Group is established by 18 founders out of Jack Ma's apartment in Hangzhou. Later that year, Alibaba Group launches a China market place, 1688, and raises US$5 million from a consortium of investors.

2000 Alibaba Group raises US$20 million from an investor group led by SoftBank.

2001 Alibaba.com surpasses 1 million registered users.

2003 Online shopping platform Taobao Marketplace is founded, again in Jack Ma's apartment.

2007 Alibaba's monetisation platform Alimama is launched.

2008 Taobao Mall (currently known as Tmall), a third-party commerce platform for brands and retailers, is launched to complement Taobao Marketplace.

2009/10 Alibaba Group holds the first 11.11 Global Shopping Festival. One of Alibaba's global consumer marketplaces, AliExpress, is launched in addition to the Taobao Mobile App.

2012 The combined GMV (Gross Merchandise Value) of Taobao Marketplace and Tmall surpasses RMB 1 trillion (~US$161 billion) in the first 11 months of 2012.

2014

Alibaba Group goes public on the NYSE and Alipay's parent company Ant Group is formally established.

2020

Alibaba officially launches Taobao Deals, a dedicated e-commerce app featuring factory-direct deals and custom-made products. GMV transacted in the Alibaba ecosystem surpasses US$1 trillion for fiscal year 2020.

2021

Regulators cancel the IPO of Ant Group, which was to be spun out of Alibaba following a now infamous speech from Jack Ma and an anti-trust probe is launched into Alibaba.

2022

Alibaba gets approval for a dual primary listing in Hong Kong expanding its investor base and limiting risks to a NYSE

Business Units

Alibaba Group

China Commerce: Taobao, TMALL天猫, 闲鱼 Idle Fish, 淘特 Taobao Deals, 淘菜菜 Taocaicai, 1688.com

International Commerce: Lazada, AliExpress, trendyol, daraz, 阿里巴巴国际站 Alibaba.com

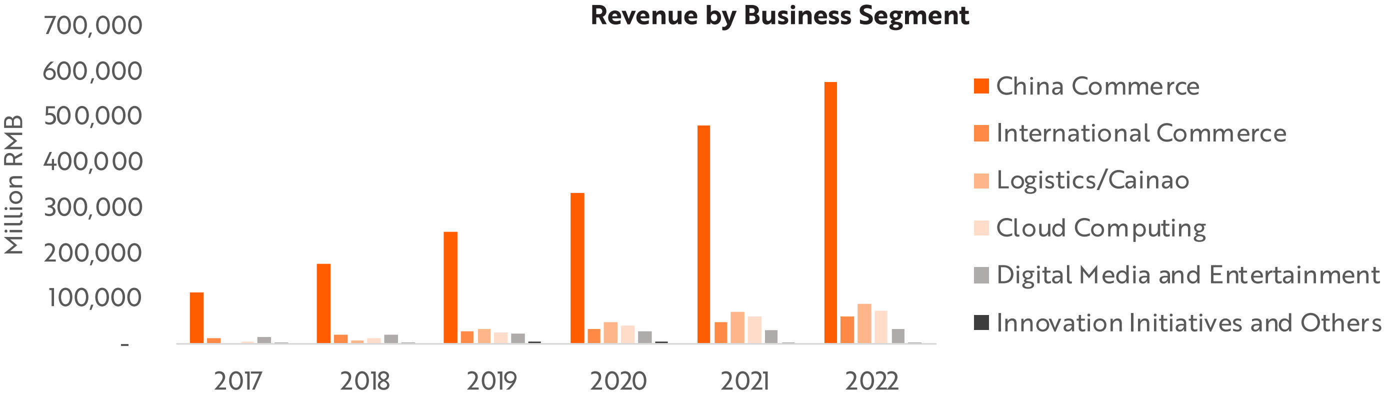
Local Consumer Services: 饿了么 Ele.me, 高德地图 Amap, 飞猪 Fliggy, 淘鲜达 Taoxianda

Logistics: CAINIAO 菜鸟

Cloud Computing: Alibaba Cloud, DingTalk

Digital Media & Initiatives: YOUKU, 阿里巴巴影业集团 Alibaba Pictures, DAMO, 天猫精灵 Tmall Genie

Alibaba's suite of businesses encompass huge swathes of the Chinese economy including Taobao Marketplace, China's dominant social commerce platform; Tmall, a third-party online and mobile commerce platform for brands and retailers; Alimama, 1688.com and Alibaba.com, online wholesale marketplaces; AliExpress, a retail marketplace; Lazada, Trendyol, and Daraz, international e-commerce platforms; and Tmall Global and Kaola, import e-commerce platforms. Cainiao Network, Alibaba's logistic services platform; Ele.me, an on-demand delivery and local services platform; and Fliggy, an online travel platform. In addition, the company offers pay-for-performance, in-feed, and display marketing services; Taobao Ad Network and Exchange, a real-time online bidding marketing exchange. Further, it provides elastic computing, database, storage, large-scale computing, security, management and application, big data analytics, machine learning, and Internet of Things services through Alibaba Cloud. Taobao, Tmall and Alibaba (domestic e-commerce), form the lion's share of revenues acounting for ~70% in 2021, however international commerce and cloud services are rapidly growing in importance. In many respects Alibaba looks a lot like a conglomerate, Alibaba's businesses have separate boards, and even separate technology teams and platforms. However, Alibaba is making the case for a strategy approach that has fallen out of favour in the U.S. While conglomerates are increasingly rare in the West, they continue to be successful in China. Alibaba's businesses are not completely diverse. There is a central theme behind them all, the rise of internet usage in China. The rapid development of internet-of-things technology is expected to further digitise physical surroundings, providing ever more data. As these innovations accumulate in the coming decades, the winners will be companies that analyse data faster than the competition.



Data Source: UBS

Global E-commerce-Industry Insights

Through Taobao, Tmall and Alibaba.com, Alibaba Group moves approximately twice the Gross Merchandise Value (GMV) of Amazon. This is just the GMV of Alibaba's domestic Chinese e-commerce market, (International e-commerce represents a further ~10%). Of course this is much easier to do when you operate a duopoly in the largest e-commerce market in the world. Last year, e-commerce sales in China stood at US$1.3 trillion and that number is projected to increase to almost US$2 trillion by 2025. This would mean that in three years, almost every second e-commerce dollar could be spent in China. Alibaba is facing intense competition from rival e-commerce platforms JD.com and Pinduoduo. However, Pinduoduo has been relying heavily on various marketing strategies and particularly cash concessions to fuel user growth, and the question still remains as to how effectively Pinduoduo will be able to retain users once the platform cuts down on such incentives. Alibaba outshadows its competitors in terms of both the total GMV transacted by users and the average GMV spent per active consumer. In 2020, the total GMV transacted on Alibaba's China retail platforms (namely Taobao and T-Mall) was 2.5 times the amount transacted on JD.com and almost 4.0 times the amount transacted on Pinduoduo, while the average Alibaba consumer spent 1.6 times more than the average JD.com user and 4.3 times more than the average Pinduoduo buyer in the same year, reflecting the success of Alibaba's predominantly middle-market commerce strategy. Compared with its peers, JD.com seems to be growing at a noticeably slower rate in terms of GMV transacted, due to its product ownership model. JD.com's penetration rate is also substantially lower than Alibaba's and Pinduoduo's, which can be explained by the company's primary focus on higher premium products which don't appeal to as large a percentage of the Chinese population.

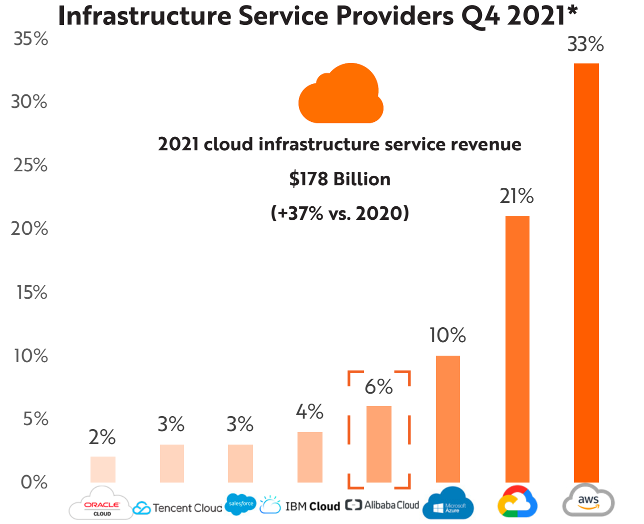
E-commerce market share in 2021, based on Gross Merchandise Value (GMV)

South East Asia E-commerce and Cloud Servers

In the Southeast Asia (SEA) e-commerce market, Alibaba's Lazada is facing intense pressure from rival Shoppe, who has outclassed its rival for the most part, and now has a similar market share in the SEA e-commerce market. However, both platforms are compelling from the merchant's point of view offering a myriad of growth channels for SME's (Small & Medium-Sized Enterprises). Alibaba's cloud segment is growing quickly, and is the largest cloud provider in China, offering a more flexible pricing plan than comparative cloud providers. The commercialisation of cloud computing and artificial intelligence (AI) has made large-scale computational power and analytic capabilities accessible to all Chinese SME's. Indeed, the cost of storing and computing large quantities of data has dropped dramatically over the past decade. This means that real-time applications of machine learning are now possible and affordable in more and more environments.

SEA Quarterly Revenue from International E-Commerce Retail (ex China)

Global Market Share of Cloud Infrastructure Service Providers Q4 2021*



Source: Synergy Research Group/statista *Includes platform as a service (PaaS) and infrastructure as a service (IaaS) as well as hosted private cloud services.

A Snapshot of...

Ant Group & Taobao

When Alibaba launched Ant, in 2012, the typical loan provided by large banks in China was in the millions of dollars. The minimum loan amount, about RMB 6 million (~US$1 million), was well above the amounts needed by most SMEs. Alibaba realised they had the ingredients for creating a high-functioning, scalable, and profitable SME lending business from the huge amount of transaction data generated by the many small businesses using their platforms. So in 2010, Alibaba launched a pioneering data-driven microloan business to offer loans to businesses in amounts no larger than 1 million RMB (~US$160,000). In 2012, the microloan business was bundled with Alipay to create Ant Financial Services. Ant Group has a default rate of about 1%, far below the World Bank's average microloan default estimate of 4% worldwide. This is how Alibaba was able to achieve such phenomenal success with Ant Group and Taobao.

1 "Datafying" Customers

Ant was fortunate to have access to plenty of data on potential borrowers, via Alibabas range of platforms to answer the questions inherent in its lending business. For many businesses, the data capture process will be more challenging. But live data is essential to creating the feedback loops that are the basis of machine learning.

2 "Software" Every Activity

Reactivity in real time is a key pillar of "smart business". The first step is to build a model of how humans currently make decisions and find ways to replicate the simpler elements of that process using software. The growth of Taobao, the domestic retailing website of Alibaba Group, has been explosive driven by continuous "softwaring" of the retailing process. One of the first major software tools built on Taobao was an instant message tool called Wangwang, through which buyers and sellers can talk to each other easily. Using the tool, sellers greet buyers, introduce products, negotiate prices, just as people do in a traditional retail shop.

3 Get Data Flowing

In ecosystems with many interconnected players, business decisions require complex coordination. Taobao's recommendation engines, for example, need to work with the inventory management systems of sellers and with the consumer-profiling systems of various social media platforms. As the platform grew from a forum where buyers and sellers could meet and sell goods to become China's dominant e-commerce website, merchants on the site needed more and more support from third-party developers. Today, merchants on Taobao subscribe to more than 100 software modules on average, and the live data services they enable drastically decrease merchants' cost of doing business.

4 Apply the Algorithms

Once a business has all its operations online, it will experience a deluge of data. To assimilate, interpret, and use the data to its advantage, the firm must create models and algorithms that make explicit the underlying product logic or market dynamics that the business is trying to optimise. Today, when customers log onto Taobao, they see a customised webpage with a selection of products curated from products offered by millions of sellers. The selection is generated automatically by Taobao's powerful recommendation engine. Its algorithms, which are designed to optimise the conversion rate of each visit, churn data generated across Taobao's platform, from operations to customer service to security.

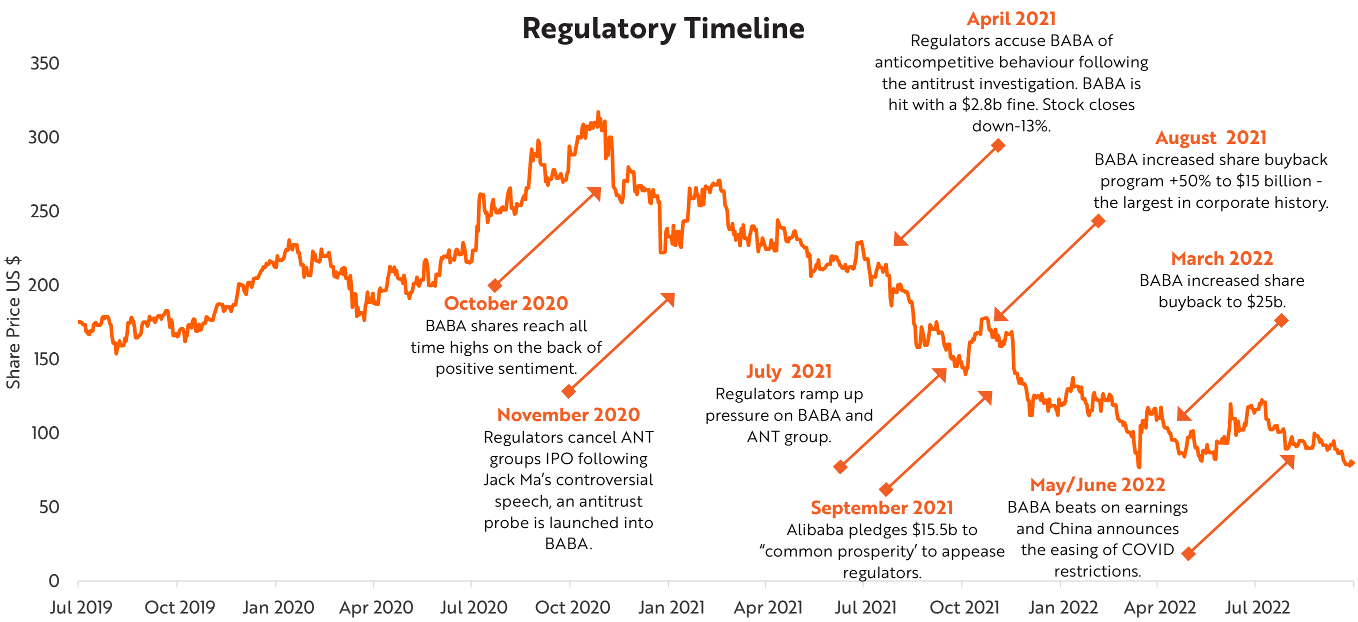
Market Dominance Caught Up with Alibaba...

The current regulatory and economic environment in mainland China is undergoing a period of extreme uncertainty. Since the days of Chairman Mao, the State Council and CCP have fostered ideologies rooted firmly in communist leadership. However, over the four decades since Mao's departure, China's economy has experienced nothing short of an economic miracle, and is set to become the world's largest economy by 2030. None of this was possible without a good dose of capitalism, leaving the values of China's CEOs and governing bodies in sharp contrast. These values were thrust into public display following Jack Ma's speech (November 2020) in which he criticised "outdated supervision" of financial regulation that was stifling innovation. Three weeks after his speech, the highly publicised IPO of Ant Financial, which was to be spun out from Alibaba was put on hold and an anti-trust probe was launched into Alibaba. Yet this was just the beginning.

Ma has long been the poster boy for Chinese technology and finance, bringing China to the forefront of e-commerce. In the past, he has been outspoken and is known for his controversial speeches, but regulators believed he had finally crossed the line in November 2020.

Officials published a draft of new stricter rules for online micro-lending companies like Ant Group following Ma's speech cancelling the Ant Group IPO citing "significant change" in the regulatory environment. Ant Group was due to list on the stock market in a world-record $37 billion deal that would value the company at more than US$300 billion.

Decades of extraordinary economic growth in China has caused some of the most severe income inequality in the world. The CCP's common prosperity regime aims to increase output through factors such as labor, capital and productivity while reducing inequality via redistribution through taxes, transfers and donations.



Over the past 12 months, the Chinese government has embarked upon a regulatory tightening cycle unprecedented in terms of its duration, intensity, and scope. Regulations targeting specific sectors, including internet platforms, education, and property markets have wiped out well over US$1 trillion of market cap from Chinese equities since their peak in mid-February 2020. At the same time, President Xi Jinping announced a new "Common Prosperity" agenda to promote more sustainable and equitable growth. It is expected that Chinese firms will make contributions to the nations common prosperity scheme, as Alibaba did with a US$15.5b "donation" in 2021. Alibaba's share price declined sharply from its highs on the back of hugely negative regulatory sentiment, a downturn in the economy and stiffer competition from its rivals.

The Chinese Tech Crackdown

The ubiquity of tech has led to growing concerns over possible abuses of market power, data security and consumer privacy. China, much like the US, has historically been relatively hands-off when it comes to the tech sector, leaving policymakers to catch up in addressing concerns by imposing sweeping regulations. The time lag between technological advancement and regulatory catch-up has always been structural in nature, and almost every country experiences a point at which various technologies outpace regulators' understanding of them. But the lack of regulation of the tech sector in China and the platform economy in particular, which had been perceived as somewhat of a "wild west", ultimately posed an almost existential threat to the CCP. The massive amount of consumer data that Chinese companies aggregated during the pandemic motivated the CCP to finally fill the regulatory gap. The West is going through its own "tech lash", and shares the same goals as Chinese authorities in many respects, but what's different about China is that regulation is highly politicised, and is ultimately all about serving the interests of the party. The CCP has demonstrated that they won't allow any kind of disruption, including those caused by tech innovation, to jeopardise the overarching goal of maintaining social stability and order. But even with this mindset, the Chinese government has also been largely pragmatic over the last four decades giving the private sector some degree of freedom to innovate and grow.

All told, China's regulatory intentions and goals are strikingly similar to those of other countries. The one glaring difference is that China has taken a far stronger, and, arguably, more heavy-handed approach to regulation and enforcement, which has had a significant negative impact on investor sentiment and markets in the short term. China has come a long way in establishing a market economy, but it has a history of more proactive government interventions in the economy than the US. While government intervention in China is often motivated by public interest or the legitimate goals of the state, policymakers are still learning how to delineate the boundary between the state and the private sector and to communicate their intentions and goals more clearly and consistently without spooking markets. Perceived heavy-handedness is due both to tradition and the fact that China is still trying to figure out how to properly regulate an increasingly large, complex, dynamic and innovative economy.

Recent regulatory measures may be an amplification of existing trends, however it would be wrong to say that the CCP is becoming more socialist and is fundamentally moving to squeeze out capitalism in China. As we saw with the recent announcement of a new stock exchange in Beijing, the party is trying to strike a balance between asserting oversight and control over market mechanisms while also ensuring that China is able to maintain sufficiently robust, albeit constrained, capital, technology, and talent markets. The CCP is not looking to move away from markets; it wants and needs markets. It is instead trying to ensure that markets are leveraged to drive the strategic outcomes that serve the CCP and China's national goals.

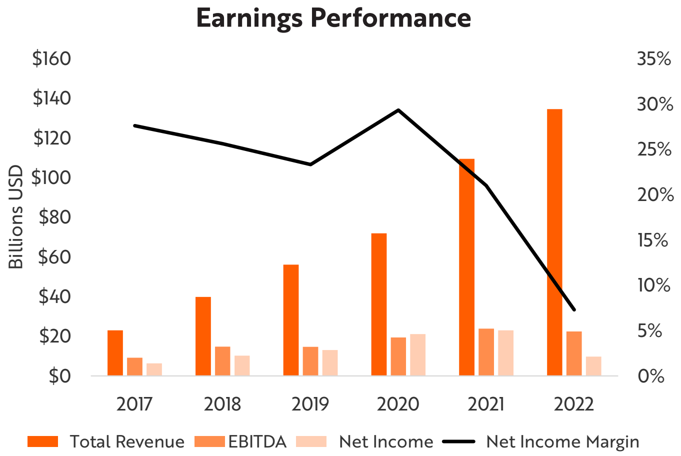
As laid out in a series of high-level planning documents like the 14th Five-Year Plan and the 2035 goals for achieving "socialist modernisation", the CCP's primary objectives over the next 10 to 15 years are to achieve self sufficiency and market dominance in the industries and technologies critical to China's national security and sovereignty, and to ensure that there's enough capital directed to these industries to power China's continued rise and overcome secular economic challenges like the middle-income trap, demographic headwinds, and slowing productivity growth. This approach is different from the command and control methods of the Soviet Union in the 1950s and 60s, but it's also a break from the looser regulatory approach that China has taken in recent decades. This means that some sectors, such as financial services, will continue to see liberalisation, as the CCP's current strategy is focused on ensuring positive inflows of capital, through domestic markets toward high-priority sectors like semiconductors, AI, integrated circuits and robotics.

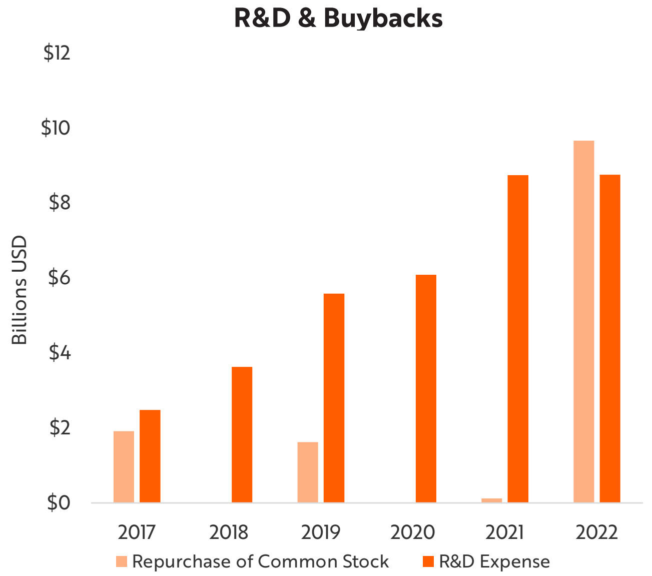
Earnings & Capital Allocation

2020 was an abnormal year for Alibaba. Mandatory COVID lock downs saw consumers forced to do almost all of their shopping from home, leading to a stunning rise in profitability for the company. The following years however could be characterised as far less impressive. A weak macroeconomic outlook for China in 2021, strong competition and unprecedented regulation have all impacted Alibaba's bottom line, reducing net income margins from 30% in 2020 to 5% in 2021. In aggregate Alibaba has suffered slowing revenue growth and increased spending, not a great recipe for strong margins.

However, it isn't all bad news.

Alibaba has embarked on a strategy of waiving merchant fees to increase retention on their platforms, pinching short-term revenue in favour of longer-term stability. From 2021 onwards Alibaba ramped up R&D spending, sales and admin expenses also increased in response to new competition and anti monopoly laws. Management has shown proficiency in capital allocation. Alibaba is acting in a shareholder centric manner, repurchasing stock at attractive prices, through a combination of debt, and drawings from its enormous cash reserves. A criticism of buybacks is that they are often ill-timed, companies will buy back shares when they have plenty of cash or during a period of financial health for the company and the stock market. The opposite is true for Alibaba. We believe Management has been very astute in buying such large quantities of stock when the share price is at multi-year lows and very depressed multiples relative to global peers.





Data Source: Capital IQ / Elevation Capital

In the long run, we strongly believe in the resilience and potential of China's economy. We will strengthen our fundamentals during this unique period, focus on innovation and customer value creation, and continue investing and planning for Alibaba's long-term growth.

-Daniel Zang Chiarman & CEO (2022 Earnings Call)

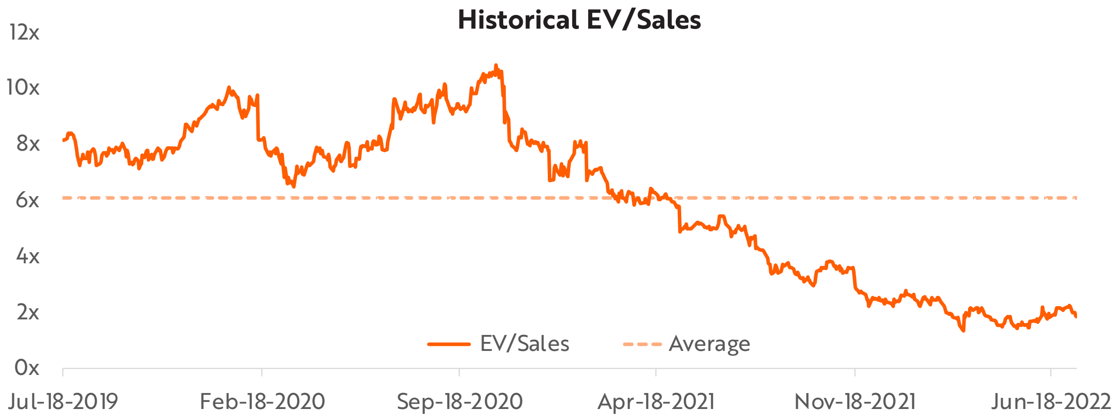
Valuation

We believe the market has presented the Elevation Capital Global Shares fund with an opportunity to acquire a fractional interest in China's dominant e-commerce platform at a compelling valuation. For the past two years Alibaba has been battered with constant regulatory pressure, leading to sizable investment outflows across the entire Chinese platform software sector. We believe this climate of fear has led investors to sell the stock down to levels well below its intrinsic value, we see this as a clear sign of the inefficiencies of the market and in this we find opportunity.

We have assessed a valuation range for Alibaba via the three methodologies below:

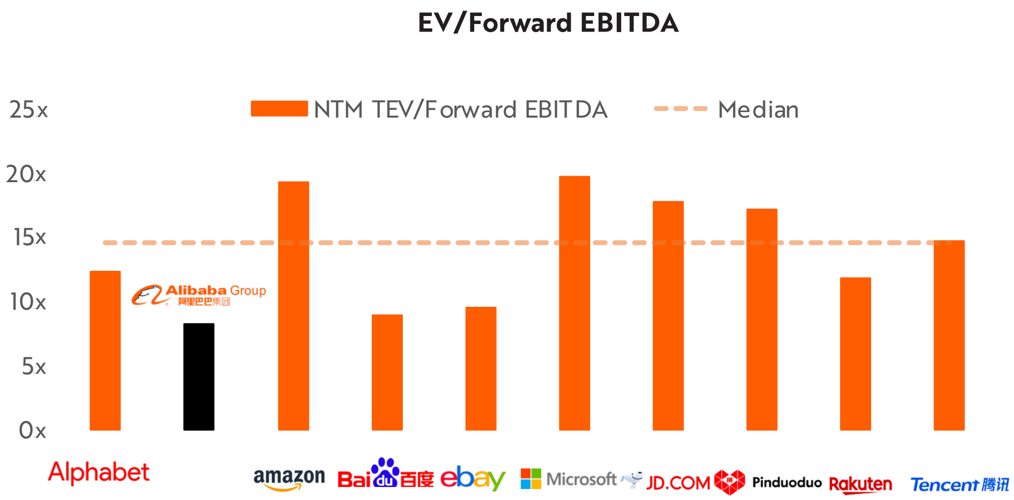
(1) EV/Sales:

Alibaba is trading at historically low levels on an EV/Sales basis, as sales have marched higher despite significant impacts to margins and profitability. On an EV/Sales basis of ~2x Alibaba is far cheaper than peers and Hang Seng heavyweights Tencent and Meituan, trading at ~5x. While this looks very attractive, it also prices in significantly slower revenue growth for Alibaba going forward. We are not overly concerned here, as we anticipate that margins should improve towards prior levels, given time.



(2) EV/EBITDA:

We have compared Alibaba across a range of Chinese and US platform software companies. We can observe that newcomers JD.com and Pinduoduo trade at relative premiums, factoring their higher growth rates in the medium term. Aside from Baidu, Alibaba trades at a discount to its peers in the Chinese markets and at a significant discount to Amazon. In a lot of respects Amazon and Alibaba offer very similar services, spanning e-commerce, cloud and digital media. Despite moving a far greater GMV than Amazon and operating China's dominant cloud platform in the world's fastest growing e-commerce and cloud markets, Alibaba and indeed the vast majority of Chinese platform tech companies trade at significant discounts to their American counterparts. This Chinese discount is to a large degree justified by the increased risk investors are exposed to with an investment in the Chinese market, yet we do not believe that this increased risk justifies Alibaba's current ~60% discount to Amazon.



Valuation Continued

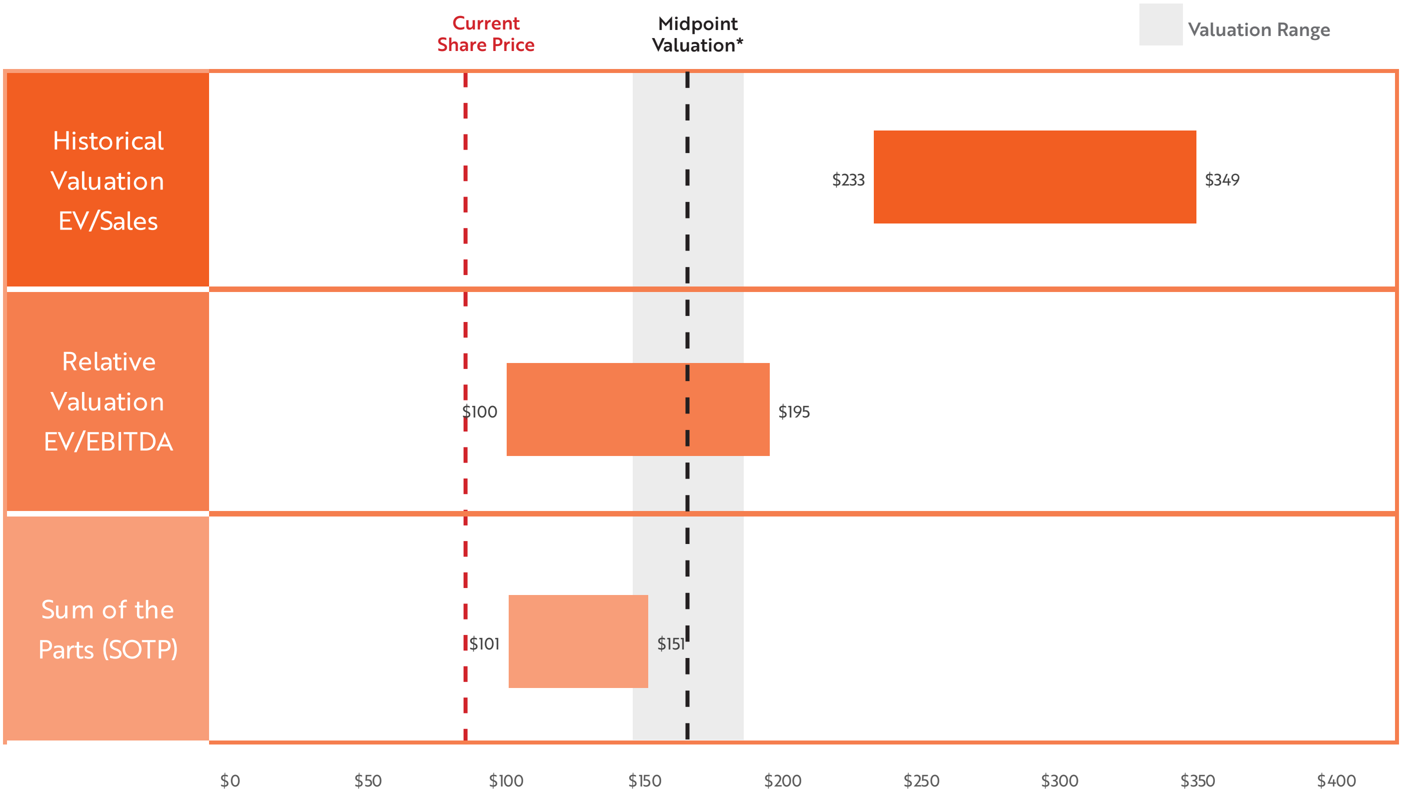
(3) Sum-of-the-Parts, (SOTP):

Alibaba's business is large and sprawling. As such we have utilised a SOTP to derive an intrinsic valuation for Alibaba should each underlying business segment be valued as a stand alone entity. We have used discounted multiples to assess the stand alone value of each individual business segment and arrive at a conservative valuation of HK$126 estimate for Alibaba shares based on the SOTP.

	Value HK$	Per Share HK$	%Value	Multiple Approach
China Commerce	$ 1,132,482	$51	41%	*8x EBITDA (20% discount to NTM EV/EBITDA)*
International Commerce	$ 199,175	$9	7%	*3.5x P/S (15% discount to Sea Limited, Shoppe)*
Alibaba Cloud	$ 304,673	$14	11%	*4x P/S (slight discount to AWS)*
Digital Media and Entertainment	$ 14,188	$1	1%	*0.5x P/S (~iQIYI)*
Innovation Initiatives	$ 4,867	$0	0%	*3x P/S (~Googles Other Bets/Metas Reality Labs)*
Ant Group	$ 130,698	$6	5%	*66.7% Discount to Pre IPO Price*
Other investments	$ 458,316	$21	16%	*20% discount to cost*
Net cash	$ 535,000	$24	19%	*N/A*
Total Value HK$		$126		

Valuation Summary

Via our three methodologies we are able to determine an approximate intrinsic value for Alibaba. Our blended valuation range for Alibaba is between **HK$150 - HK$185 per share**, representing a premium of **+92% - +137% from the closing price of HK$77.95** as at 30 September 2022.



**Midpoint valuation obtained via the following weightings: 20% Historical EV/Sales, 40% Relative Valuation EV/EBITDA, Sum of the Parts 40%.*

Conclusion

Alibaba's ecosystem of e-commerce, logistics and cloud computing, provides it command over half of the largest e-commerce market in the world. Despite having a lot thrown in its path Alibaba has shown remarkable resilience and management has displayed intelligent capital allocation. Over the long-run Alibaba is still well placed to benefit from the rise of internet access and household incomes across China and South East Asia which should be bolstered by Chinas "Common Prosperity Scheme". As the CCP perhaps starts to show the first signs of easing restrictions we have taken the opportunity to acquire a fractional interest in this world leading business. Once regulatory fears have eased, we believe institutional investors will return to the company, and we anticipate a re-rating of Alibaba shares from currently depressed multiples.

This summary report was written in July - September 2022.
Any data not referenced was sourced from Alibaba annual reports and conference calls.
1 Capital IQ accessed at 22 July 2022
2 UBS Neo accessed at 20 July 2022
3 Harvard Business Review (2018). Alibaba and the Future of Business.
Accessed at: https://hbr.org/2018/09/alibaba-and-the-future-of-business

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ELEVATION CAPITAL
GLOBAL SHARES FUND

Independent Thinking Disciplined Investing

[In-de-pend-ent Think-ing] indəˈpendənt THiNkiNG verb
Is essential to long-term investment success. We are often contrarian and do not pay attention to index compositions when making investment decisions. We believe that when you're several thousand miles away from Wall Street in a different nation, it's easier to be independent and buy the things that other people are selling, and sell the things that other people are buying.

[Dis-ci-plined In-vest-ing] disciplinəd invesˈting verb
The market presents opportunities every day, but disciplined investing is as much about the opportunities you do not take. We also believe that cash is sometimes the most attractive investment.

MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2017, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2013, NEW ZEALAND

NOMINEE - MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

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