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Conservative Pricing Creates Opportunity for Wide-Moat Alibaba

Understanding the assumptions behind our $90 fair value estimate, high uncertainty, and poor stewardship ratings.

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Executive Summary

Alibaba's long-awaited initial public offering is expected to price on Sept. 18 and trading set to begin the next day. The company recently raised its price to between $66 and $68 per American depository share (ADS) compared with its initial $60-$66. Perhaps learning lessons from Facebook's IPO, Alibaba's current pricing range strikes us as conservative, and we do not believe the valuation fully reflects the features that make the wide-moat Alibaba investment story unique. Based on 2.5 billion shares outstanding after the offering (assuming underwriter options have been exercised) and a discounted cash flow-derived equity value of $223 billion, we assign Alibaba a fair value estimate of $90 per ADS.

Nevertheless, we acknowledge that there are several geographic, regulatory, and corporate structure risks inherent to investing in Alibaba, which are reflected in our high uncertainty and poor stewardship ratings. As such, we believe the IPO is most appropriate for investors with higher risk tolerance looking to increase their exposure to China's emerging middle-class consumer base and its online commerce, mobile commerce, technology, and logistics industries.

Key Takeaways

- Reaffirming our wide moat and stable moat trend ratings. Alibaba's recent top-line growth trends have been supported by an increase in the number of active buyers and sellers, supporting the network effect underpinning our wide moat rating. We continue to believe that structural differences in China's retail industry and Alibaba's mobile investments will protect its network effect, even as China moves from a consumer-to-consumer to a business-to-consumer e-commerce market, resulting in a stable moat trend.
- Our $90 per ADS fair value is based on a revenue CAGR of 32% and operating margins expanding to 50.2% from 47.5% over the next five years. Our top-line assumptions are due to several macroeconomic, socioeconomic, regulatory, and industry growth drivers, while a scalable third-party platform should allow Alibaba to generate margins well ahead of its peers.
- Assigning Alibaba high uncertainty and poor stewardship ratings. We've assigned a high uncertainty rating based on competitive, regulatory, and execution risks, while our poor stewardship rating balances management's solid execution with concerns about its variable interest entity (VIE) structure, partnership committee, and Alipay transference.

Companies Mentioned

Name/Ticker	Economic Moat	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Morningstar Rating	Credit Rating	Market Cap (Bil)
Alibaba Group	Wide	Stable	USD	90	67	High	NA	NA	NA
Amazon.com AMZN	Wide	Stable	USD	400	327.76	High	★★★★	A-	151.44
EBay EBAY	Wide	Positive	USD	63	51.75	Medium	★★★★	A+	64.06

Conservative IPO Pricing Range Underappreciates Alibaba's Longer-Term Potential, but Investors Must Understand the Risks

With Alibaba's IPO expected to price on Sept. 18 and trading expected to commence the following day, we are publishing this piece as a supplement to our earlier report *A Powerful Network Effect in a Rapidly Growing Industry Makes Alibaba a Rare Find*, which provided a preliminary look at the company's moat, moat trend, and valuation. The valuation assumptions behind our discounted cash flow model remain largely intact, with only modest adjustments to our preliminary enterprise and equity value based on incremental technology infrastructure, product development, and marketing investments, but also slightly higher long-term operating margins stemming from an increase in monetization trends.

We have assigned Alibaba an initial fair value estimate of $90 per ADS, which implies an enterprise value of CNY 1,329 billion ($214 billion) and an equity value of CNY 1,387 billion ($224 billion). Our fair value estimate represents an attractive 32%–36%% premium over Alibaba's latest expected pricing range of $66 to $68 per ADS. In this report, we take a closer look at the four pillars of Morningstar's approach to evaluating equities and how they apply to the Alibaba investment thesis: 1) economic moat and moat trend; 2) valuation; 3) uncertainty; and 4) equity stewardship. While we view Alibaba's initial pricing range as conservative relative to the company's tremendous growth potential, we believe investors must incorporate a wide margin of safety given Alibaba's unique set of geographic, regulatory, and corporate structure risks, which we evaluate in this report.

Pillar 1: Reaffirming Our Wide Moat Rating Based on Alibaba's Network Effect, Brand Intangible Asset, and Scalable Model

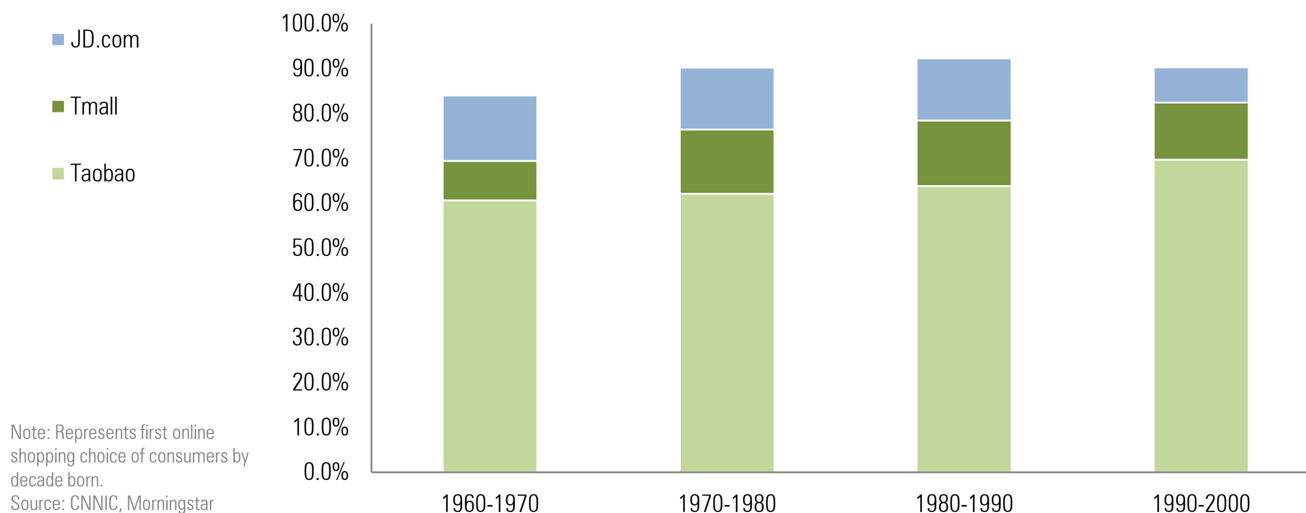
We have assigned Alibaba a wide moat rating largely because of a strong network effect, where the value of the platform to consumers increases with a greater number of sellers (and vice versa). A network effect is among the rarest of the five sources Morningstar uses to assess a company's economic moat and one of the most powerful, as it can often result in a multidecade period of excess economic returns. Alibaba's network effect is unusual, having been established in an industry (China e-commerce) at a relatively early stage in its life cycle. Many of the other companies that Morningstar has assigned network-effect moat sources participate in more mature industries.

Alibaba's network effect is based on operating some of the most popular online marketplaces in China, including Taobao, Tmall, and Juhuasuan, which together generated a gross merchandise volume, or GMV, of CNY 1,678 billion ($271 billion) in fiscal 2014, more than Amazon and eBay combined (which accounted for $116 billion and $88 billion, respectively, based on data from International Data). As a third-party e-commerce platform operator, Alibaba allows millions of buyers and sellers to connect, explore, and transact with each other. The company boasted 279 million active buyers (representing 21% of the total Chinese population) and 8.5 million active sellers for the trailing 12-month period ending June 30.

We Believe Alibaba Is Well-Prepared for Shift from C2C to B2C

Unlike other developed countries where the e-commerce market is dominated by business-to-consumer (B2C) players like Amazon, Tesco, Otto, and others, consumer-to-consumer (C2C) marketplaces accounted for almost 64% of China's total online shopping GMV in 2013, according to data from iResearch. We expect a more pronounced shift to B2C e-commerce in the years to come as 1) other large domestic and foreign B2C platforms bolster their presence in China; 2) traditional retailers increasingly embrace multichannel models; and 3) Chinese consumers demand higher-quality and branded goods. Although we don't consider the network effect among Alibaba's B2C marketplaces to be as strong as its C2C marketplaces, we believe the network effect inherent in the Taobao Marketplace (which is often the first destination for Chinese online shoppers, as shown in Exhibit 1) enriches the company's entire ecosystem, providing low-cost organic traffic for other B2C marketplaces like Tmall and Juhuasuan while reducing Alibaba's reliance on a salesforce for marketing services. The Taobao marketplace allows Tmall's product offering to be listed on its search result pages. By diverting significant buyer traffic to the Tmall marketplace, Taobao helps Tmall gain user traffic in an extremely cost-effective manner. As such, we believe Taobao will be instrumental in helping Alibaba adapt to changes in China's e-commerce landscape.

Exhibit 1. Taobao Is Usually the First Online Shopping Destination for Chinese Consumers Across Multiple Generations

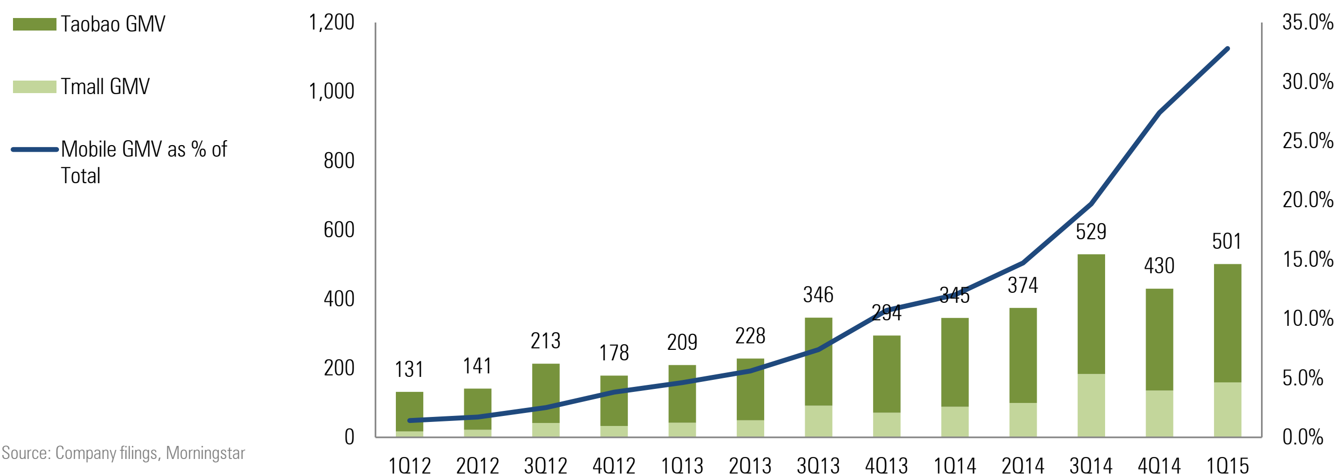


Note: Represents first online shopping choice of consumers by decade born.
Source: CNNIC, Morningstar

Tmall, with its improved product quality assurance and enhanced user experience, has also become an increasingly important revenue driver for Alibaba. According to Alibaba's latest F-1 filing, GMV on Tmall marketplace grew by 90% and 81% year over year in the past two quarters, respectively. In the first quarter of fiscal 2015, GMV on Tmall accounted for 31% of total GMV on Alibaba's retail marketplaces in China, up from 13% three years ago. We expect China's traditional C2C marketplaces to mature further, while demand for high-quality branded products continues to grow. Moreover, as online shopping becomes an increasingly integral part of daily life of Chinese consumers, we believe Tmall will continue

to grow faster than Taobao, and the total GMV of Tmall is likely to surpass that of Taobao in the following years.

Exhibit 2. Tmall Will Become a More Meaningful Contributor as B2C Becomes a Larger Part of China's E-Commerce Landscape (CNY Bil.)



Source: Company filings, Morningstar

China's Offline Retail Market Structure Should Protect Its Network Effect, Supports a Stable Moat Trend Rating

We expect China's fragmented and underdeveloped offline retail market to insulate Alibaba's network effect. Per capita retail space in China is significantly below that of developed countries like the U.S., Germany, the U.K., and Japan. E-commerce and mobile commerce adoption has come to a key inflection point in the evolution of the Chinese retail industry, suggesting a very different trajectory relative to retail industries in other developed markets. Given favorable consumer demographic trends and the current state of its supply chain and logistics infrastructure, we believe China's retail industry will bypass the traditional consolidation stage that most developed countries experienced and move into a channel diversification stage. As a result, we believe vendors will continue to depend on Taobao, Tmall, and Alibaba's other marketplaces in the years to come, driving increased consumer engagement and supporting our stable moat trend rating.

Competition with JD.com and Other Chinese E-Commerce Companies Has Been Exaggerated

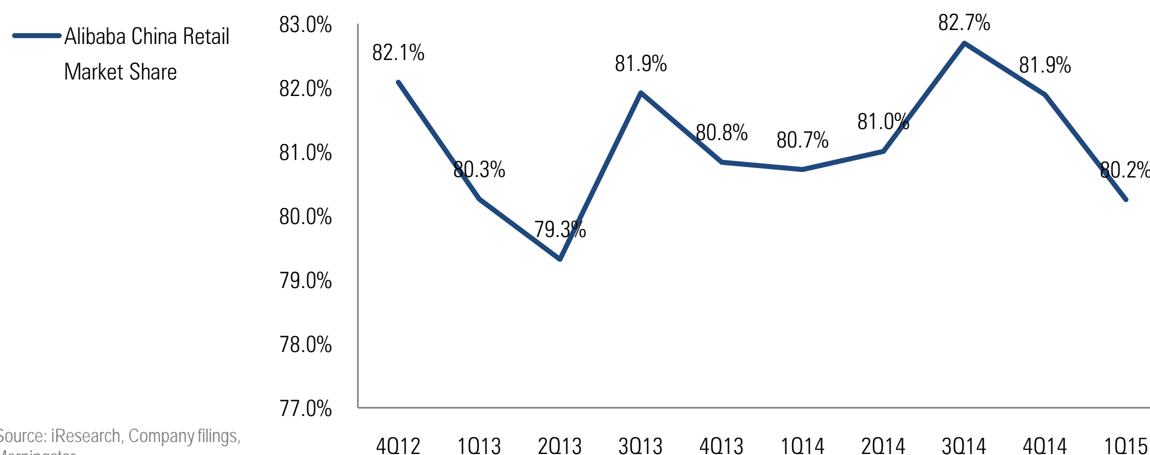
We view JD.com as Alibaba's most viable competitor in the long term. However, we consider Alibaba to have a more powerful network effect and a wider moat. We have discussed the competitive advantages and weaknesses of JD.com in our previous report and believe it is worth re-emphasizing Alibaba's competitive strengths and why we think it can defend its leadership over the long run.

First, we believe the network effect of Taobao and Tmall poses a serious challenge for competitors to replicate. In the trailing 12-month period that ended in June, Taobao and Tmall had 8.5 million active sellers and 279 million active buyers, far ahead of JD.com's 38,000 active sellers and 38 million active users during the same period. Alibaba's ecosystem is not only scalable but also highly interactive. Customers rely on the extensive number of product reviews and recommendations by millions of fellow

customers to make purchase decisions. At the same time, merchants of all kinds are attracted to the dominant user traffic of Alibaba's marketplaces. An annual survey by China Internet Network Information Center shows that product reviews are the first consideration for online shoppers. Alibaba's marketplaces, with its dominant user base, have accumulated the largest number of product reviews in the past decade.

To improve the monetization rate, JD.com has been following Alibaba's path by introducing third-party merchants to its online marketplace. We have limited confidence in this strategy, since sellers will find Alibaba's online marketplaces, with much higher user traffic, a more attractive destination. Compared with Tmall, JD.com doesn't appear to offer a significant cost advantage for third-party merchants. Online sellers need to pay a CNY 6,000 annual fee and 3%-10% of gross transaction volume with JD.com, while Tmall charges a CNY 30,000 to CNY 60,000 annual fee and a very attractive commission rate of 0.5%-5%. We believe JD.com's competitive advantage lies in the fulfillment capacity of its self-operated online store, though it is unlikely to challenge Alibaba in the online marketplace.

Exhibit 3. Alibaba Continues to Dominate China's Online Shopping Market



Source: iResearch, Company filings, Morningstar

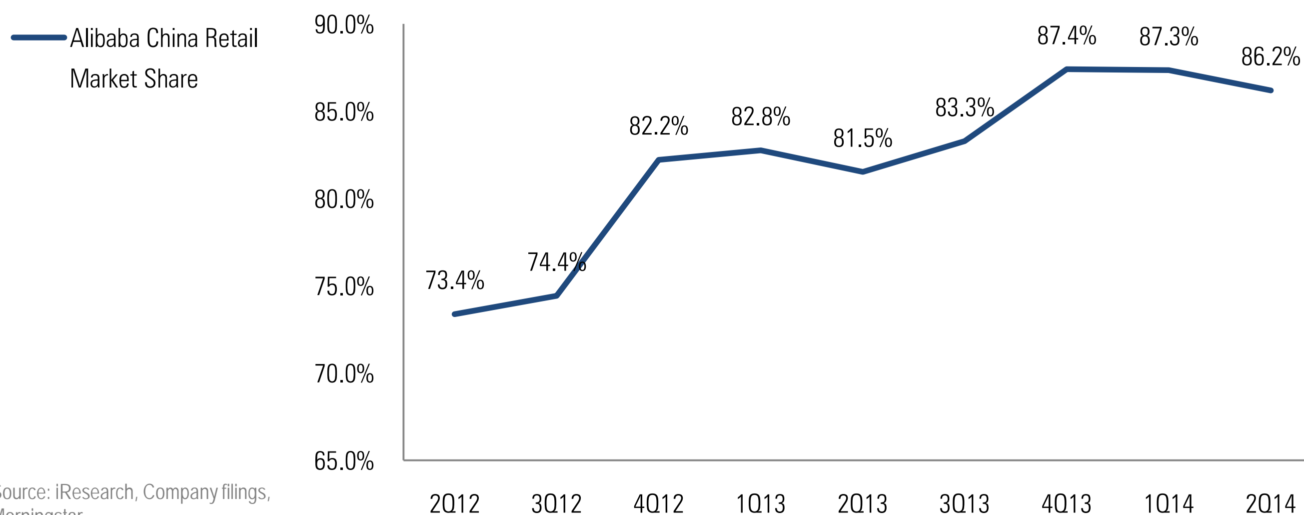
Alibaba's Network Effect Should Make a Successful Transition Into Mobile Commerce

Increased usage of mobile devices in China will make access to the Internet even more convenient, which should drive higher online shopper engagement over a longer horizon. We anticipate strong mobile commerce growth trends over the next decade, driven by 1) increased mobile device capability investments by e-commerce players; 2) improvements to China's Internet infrastructure; and 3) greater smartphone and tablet adoption among Chinese consumers. Additionally, we believe Alibaba's position as the preferred mobile shopping platform among Chinese consumers (aided by the company's acquisition of mobile browser developer UCWeb) will help to drive increased mobile monetization rates over a longer horizon.

We believe Alibaba's market leadership at the mobile end will also help protect the network effect behind our wide economic moat rating and stable moat trend. As mobile Internet and smart devices continue to proliferate across China, mobile commerce has been growing at an explosive rate and

gradually becoming mainstream. We believe Alibaba's success in the PC end gives the company key advantages against its competitors in the mobile end. Its trusted brand and self-reinforcing ecosystem convince us that the firm can copy its success to from PC to the mobile market. According to iResearch, Alibaba has been able to expand its market share in the mobile commerce market to 86% in the second quarter of 2014 from 73% in the same period in 2012.

Exhibit 4. Alibaba's Mobile Commerce Market Share



Source: iResearch, Company filings, Morningstar

More Than Just a Network Effect: Alibaba's Cost Advantages and Intangible Assets Also Support Our Wide Moat Rating

Because Alibaba's various online marketplaces are interconnected, we believe this compounds the company's network effect, which then breeds other competitive advantages. Essentially, buyers on Tmall's marketplace could also go to Taobao for a broader range of products, while Taobao users with a strong appetite for branded products could switch to Tmall for a better shopping experience and higher quality. In fact, we believe Taobao diverts a substantial amount of user traffic to Tmall, thereby lowering Tmall's customer acquisition costs.

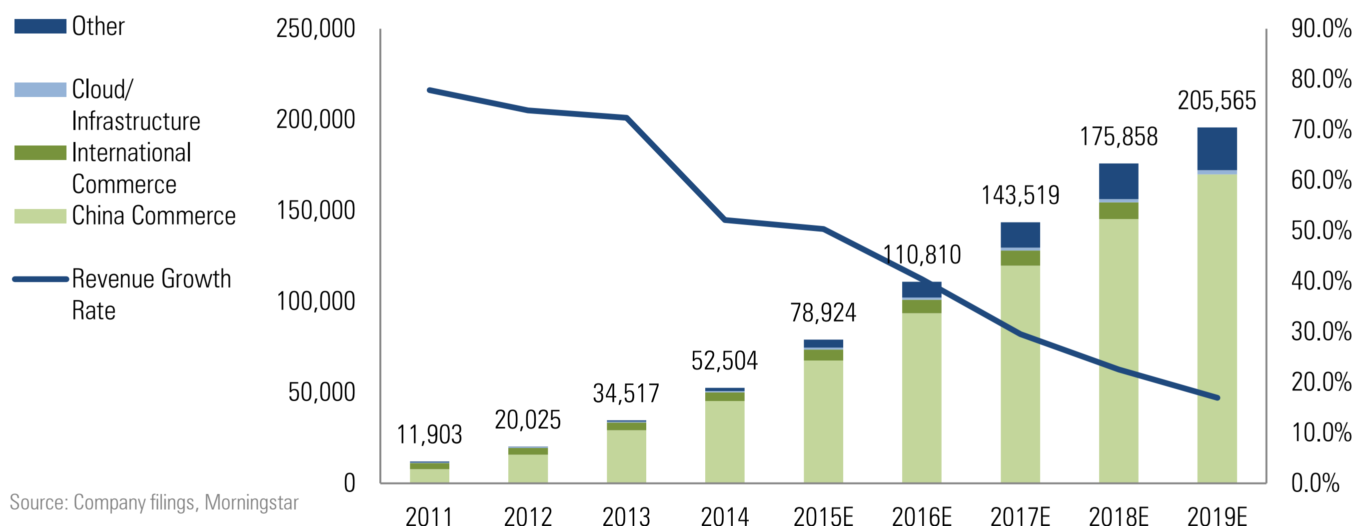
The significant economies of scale also allow Alibaba to spread fixed costs over a wider revenue base, making it China's most profitable e-commerce company. Moreover, through its China Smart Logistics subsidiary (48% owned by Alibaba), the company operates as a third-party platform without taking control of inventories—something that is unlikely to change, in our opinion—adding another layer of cost advantages and driving margins above those of JD.com and other competitors.

Pillar 2: Our $90 Fair Value Is Based on a Revenue CAGR of 32% and Operating Margins Expanding to 50.2% from 47.5% Over the Next Five Years

Combining Alibaba's self-reinforcing network effect, scalable technology and infrastructure, and several favorable macroeconomic, socioeconomic, government, and industry growth drivers, we continue to believe Alibaba offers investors one of the more compelling and sustainable growth stories across our global consumer and technology coverage.

We are initiating coverage of Alibaba with a fair value estimate of $90 per ADS. Underpinning our valuation assumptions is a compounded average revenue growth rate of 32% for the five years between fiscal 2015 and 2019. We believe the major business driver for Alibaba will still be the retail commerce segment in China. Rising spending among online shoppers, a growing user base, and a business mix shift from C2C to B2C will all contribute to the robust revenue growth of Alibaba's online retail business in China. We forecast a compounded annual average growth of 26% in GMV on Alibaba's Chinese retail marketplaces, including Taobao, Tmall, and Juhuasuan. The rapid GMV growth is driven by an active buyer base expansion of 20% per year, implying nearly 700 million active buyers, and a 5% annual average growth in average spending per buyer between fiscal 2015 and 2019. We expect the monetization rate to improve as well, as GMV from the B2C marketplace increasingly contributes to the total GMV.

Exhibit 5. Our Base Case Assumes Annual Top-Line Growth of Approximately 32% Over the Next Five Years (Revenue by Segment, CNY Bil.)



Source: Company filings, Morningstar

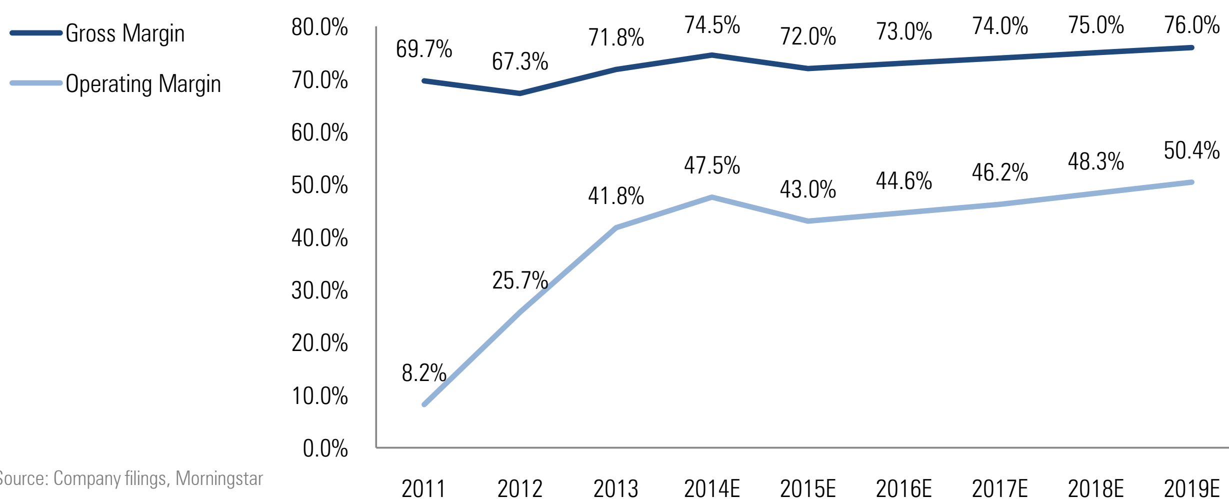
Our estimates also imply that Alibaba's GMV will outpace China's overall e-commerce growth (which we estimate at about 26% using data from iResearch), implying market share gains and a strengthening of its network effect in the process.

Despite Expectations of Increased Infrastructure Investments, Alibaba's Network Effect Lends Itself to a Highly Scalable Model

Although the firm has undeniable potential for operating leverage, we believe continuously intense competition from other e-commerce firms will force Alibaba to continue investing in technology infrastructure, traffic acquisition, and personnel. We therefore expect some contraction over the near term, with gross margins declining to 72.0% in fiscal 2014 because of technology, product development, and marketing investments (compared with 74.5% in fiscal 2013). However, we expect roughly 100 basis points of gross margin improvement annually in the next five years, largely through expense leverage, bringing our 2018 gross margin estimates to approximately 76.0%.

We expect operating margin to decline to 43.0% in fiscal 2015 from 47.5% in fiscal 2014 because the company is currently investing heavily in technology personnel, user acquisition, and developing its mobile products. We project an average of 100 basis points operating margin improvement annually after fiscal 2015 as part of the fixed costs are spread over a growing revenue base.

Exhibit 6. Alibaba's Third-Party Business Model Offers Leverage Opportunities



Source: Company filings, Morningstar

Our fair value estimate was derived by discounting three-stage cash flows with a weighted average cost of capital of 9.7% and a CNY/USD exchange rate of 6.13. The adjusted return on invested capital for Alibaba averages about 32% in our five-year projected forecast period (the firm achieved ROICs of 33.8% in 2013 and 55.5% in 2014), well above our estimated cost of capital. This supports our wide economic moat rating for the firm. Our fair value estimate of $90 per ADS implies a current fiscal 2015 price/earnings ratio of 47 times and forward a fiscal 2016 price/earnings ratio of 35 times. We acknowledge that the our valuation appears lofty using the traditional multiple-based methodology, but given Alibaba's tremendous ability to generate cash, promising business prospects, and dominant market position in one of the fastest-growing e-commerce industries in the world, we believe Alibaba deserves a premium valuation. A detailed summary of our financial model can be found in the appendix.

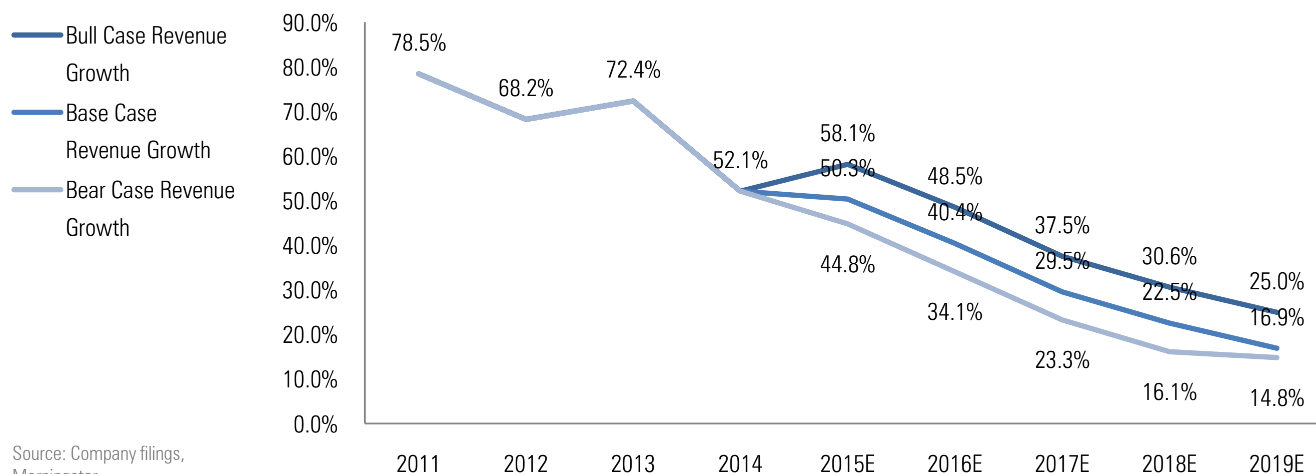
Stress-Testing Alibaba's Valuation Through Scenario Analysis

Although we are optimistic about Alibaba's longer-term growth potential, we acknowledge there are a number of company-specific, industry, and regulatory factors that could affect our long-term cash flow projections. Thus, we stress-test our valuation of Alibaba under optimistic and pessimistic scenarios. We believe future revenue and free cash flow growth will be sensitive to the speed of user expansion and improvement in monetization. Because of the increasing presence of rival B2C platforms and emergent technologies that could disrupt industry economics, we must consider a wide range of outcomes with intrinsic value assumptions:

- In our bull-case scenario, we model exceptionally successful business expansion of Alibaba through active user acquisition and robust improvement in monetization of its B2C and mobile commerce business. The stronger-than-expected growth in the user base and improvement in monetization rates (particularly with respect to mobile commerce) lead to rapid revenue growth averaging 39% annually for our five-year forecast period compared with 32% in our base-case scenario. The significant potential for operating leverage will also result in faster margin expansion. We therefore expect gross margin to improve to 78% in fiscal 2019 compared with 76% in our base-case scenario. Operating margin will expand to 56% by the end of fiscal 2019, roughly 6 percentage points higher than our forecast in the base case. Our fair value estimate under this bull-case scenario is $132 per ADS.

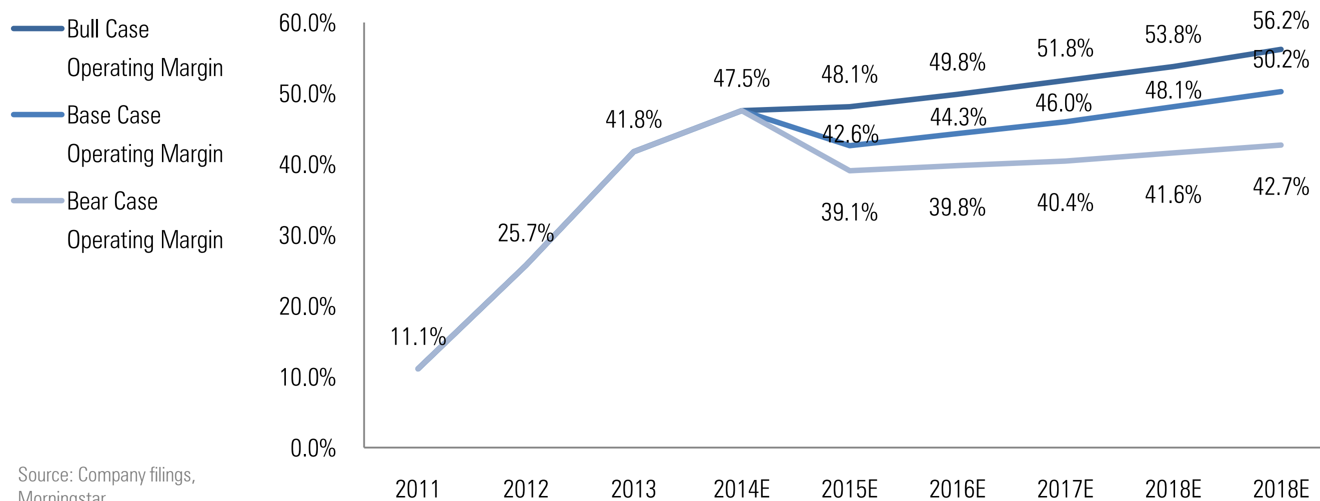
- In our bear-case scenario, we project a more pessimistic outlook for Alibaba's business expansion, primarily due to the rising challenge from its rivals, including JD.com, Suning, and Amazon. We assume more online shoppers are attracted to the efficient delivery service of JD.com and high-quality digital content provided by Amazon. The fierce competition will lead to slower-than-expected user growth and relatively underwhelming monetization improvement. The overall result is revenue growth averaging 26% annually over the next five years, 5% lower than the 31% projection in our base-case assumptions. Slower revenue growth also causes less impressive margin expansions. We expect operating margin to improve to 43% by the end of 2019, 5% lower than our assumption in the base case. Our fair value estimate under this pessimistic scenario is $65 per ADS.

Exhibit 7. Revenue Growth Assumptions Under Our Bull-, Base-, and Bear-Case Assumptions



Source: Company filings, Morningstar

Exhibit 8. Operating Margin Assumptions Under Our Bull-, Base-, and Bear-Case Assumptions



Source: Company filings, Morningstar

Pillar 3: We've Assigned Alibaba a High Uncertainty Rating Based on Competitive, Regulatory, and Execution Risks

Despite its clear dominance in China's e-commerce industry, we assign Alibaba a high uncertainty rating, which captures the range of potential fair value outcomes based on an assessment of the company's future top-line growth scenarios, operating and financial leverage, and any other events that may affect the business. In Alibaba's case, we expect the company to face elevated competition, increased regulatory risk, and the threat of the company's ancillary businesses shifting management's attention away from its core marketplaces business. We believe investors must assume a healthy margin of safety relative to our $90 fair value estimate before considering an investment, though the current offering price's discount to our fair value translates into an initial 4-star rating for Alibaba before first-day trading.

We've outlined the most pressing risks of investing in Alibaba:

- Heightened e-commerce competition in China. In our view, JD.com will be Alibaba's most credible rival over the long run. JD's competitive strength lies in fulfillment capability, quality assurance, and strategic partnership with Tencent. JD has the largest fulfillment infrastructure of all e-commerce companies in China, including 97 warehouses in 34 cities, 1,808 delivery stations, and 715 pickup stations. The fulfillment infrastructure allows JD to provide same-day and next-day delivery in 111 counties and 622 districts across China, making it attractive to consumers in regional cities where retail infrastructure is less developed. Furthermore, as JD directly sources and merchandises inventory, we believe the company maintains better control over product quality. Going forward, we expect JD.com to attract more online shoppers who value delivery time and quality assurance. Although we don't believe JD.com will threaten the network effect behind Alibaba's wide economic moat over the long term, JD's rapid expansion could disrupt the business growth and profitability of Alibaba's marketplaces.

  In addition to JD.com, Alibaba also faces competition from several domestic and foreign e-commerce companies, including VipShop, Amazon, and Suning. These companies might not have sufficient scale to compete with Alibaba, but they specialize in e-commerce of some specific products or markets. The rapid growth of these smaller players might limit Alibaba's product categories and offerings expansion.

- Increased online and mobile payment regulatory scrutiny. Alibaba's business is also exposed to regulatory risk. Financial regulators in China have been increasingly scrutinizing online and mobile payment services. Considering that roughly 80% of transactions on Alibaba's China retail marketplaces were settled through Alipay, any type of regulatory tightening and supervision policy could significantly affect Alibaba's business operations.

- Ancillary businesses and international expansion increase execution risk. Alibaba's other downside risks include expansion into peripheral businesses, which might distract management and may not materially improve Alibaba's ecosystem. We also believe the road to overseas expansion will be bumpy for Alibaba. Despite its clear dominance in China, the firm does not enjoy the same network effect and brand recognition in most other countries.

Pillar 4: Our Poor Stewardship Rating Balances Management's Solid Execution Track Record With Reservations About its VIE Structure, Partnership Committee, and Alipay Transference

Alibaba has a capable and ambitious management team. Founder and executive chairman Jack Ma has been an inspiring leader since the company's inception in 1999. Under his leadership, Alibaba has emerged to become China's dominant ecommerce player, accounting for 84% of total transaction volume of the online shopping industry. Over the past decade, Taobao's ascendance has literally transformed the shopping behaviors of millions of Chinese consumers. Management has also done an excellent job developing and strengthening Alibaba's wide economic moat by building several other leading online commerce marketplaces, including Tmall, Juhuasuan, Alibaba.com, and Alipay. We are confident that Alibaba can sustain its wide economic moat over the long term under the existing management's leadership.

Despite management's Proven Capability, We Have Concerns Regarding Alibaba's Corporate Governance, Which Is Reflected in Our Poor Stewardship Rating

Like many other Chinese Internet companies listed in overseas markets, Alibaba has adopted the variable interest entity structure, or VIE, which is specifically designed to let companies bypass Chinese legal restrictions on foreign ownership in certain sectors. Alibaba's foreign investors will essentially hold shares of Alibaba's VIEs domiciled in the Cayman Islands. We don't expect any legal challenges to VIEs by the Chinese government in the future. However, on rare occasions, if the legitimacy of Alibaba's related VIEs is found to violate applicable law or regulation, Chinese regulatory authorities might take action against the VIEs, including revoking the business and operating licenses of Alibaba's subsidiaries or the VIEs, or discontinuing, restricting, or restructuring Alibaba's operations. Since the Chinese Ministry of Commerce has the jurisdiction to regulate VIEs, we believe overseas investors will have limited legal rights and are likely to lose their investments under this scenario.

In addition, we harbor concerns about the partnership structure that might jeopardize the board's independence. Alibaba's partnership is led by a committee of five, including Ma, vice chairman Joe Tsai, and CEO Jonathan Lu. Among the 27 partners, 22 are Alibaba Group executives, while the rest are executives of affiliated companies.

Upon the initial public offering, the Alibaba Partnership will have the exclusive right to nominate up to a simple majority of the members of its board of directors. Any board candidate they nominate is presented to shareholders for voting. If the candidate is not elected by shareholders, the Alibaba Partnership can appoint another candidate, without a vote. That candidate will serve as an interim director until the next annual general meeting, where either the same candidate or yet another nominee proposed by Alibaba partners will stand for election. Despite its minority stake, the Alibaba Partnership essentially controls the board and limits the influence of outside shareholders.

After the IPO, Alibaba Group will enter a voting agreement with two of its major shareholders, SoftBank and Yahoo, as they will agree to vote favorably toward the Alibaba Partnership director nominees at the general shareholder meetings. In addition, Yahoo, Ma, and Tsai will all agree to vote in favor of one director, nominated by SoftBank. We believe these provisions could compromise board independence and increase the likelihood of conflicts of interest.

In 2011, the company transferred the ownership of Alipay to a new company—Alipay.com Co., Ltd—which is controlled by Ma, without the approval of Yahoo and SoftBank. Although a settlement has been reached between Yahoo, SoftBank, and Alibaba, we believe this is symptomatic of dubious corporate stewardship. M

Appendix

Exhibit 9. Alibaba Group Summary

Alibaba Group (BABA)

Market Cap:		Sector: Technology		Industry: Internet Content & Information		Stewardship: Standard	
Five-Star Price	54.00	Economic Moat	Wide	Valuation Multiples (2015 Estimates)		Scenarios	
Fair Value Estimate (USD)	**90.00**	Moat Trend	Stable	Adjusted P / E	34.9	Bull Case	134.00
One-Star Price	139.50	Uncertainty	High	EV / Adjusted EBITDA	28.0	Base Case	90.00
				EV / Sales	12.9	Bear Case	66.00
Market Price	67.00	Estimated COE	10.0%	Price / Book	8.6		
Price / Fair Value Estimate	0.74	Pre-Tax Cost of Debt	5.0%	FCF Yield	3.6%		
Morningstar Credit Rating	N/A	Estimated WACC	9.7%	Dividend Yield	0.0%	FY Ends:	March

	3-Yr Historical CAGR/AVG	2012	2013	2014	*Forecast* 2015	*2016*	*2017*	*2018*	*2019*	5-Yr Projected CAGR/AVG
All values (except per share amounts) in: CNY Millions										
Income Statement										
Revenue		20,025	34,517	52,504	78,924	110,810	143,519	175,858	205,565	
Gross Profit		13,471	24,798	39,135	56,825	80,891	106,204	131,893	156,229	
Operating Income		5,150	14,413	24,964	33,619	49,100	65,981	84,611	103,274	
Net Income		4,228	8,532	23,315	29,320	44,157	59,965	77,700	95,888	
Adjusted EPS		1.68	3.57	10.00	11.77	17.73	24.07	31.19	38.49	
Adjusted EBITDA		6,020	15,348	26,618	36,302	53,847	73,472	95,478	117,978	
Growth (% YoY)										
Revenue	64.0%	68.2%	72.4%	52.1%	50.3%	40.4%	29.5%	22.5%	16.9%	31.4%
Gross Profit	67.0%	60.3%	84.1%	57.8%	45.2%	42.4%	31.3%	24.2%	18.5%	31.9%
Operating Income	166.3%	289.6%	179.9%	73.2%	34.7%	46.0%	34.4%	28.2%	22.1%	32.8%
Net Income	170.1%	257.4%	101.8%	173.3%	25.8%	50.6%	35.8%	29.6%	23.4%	32.7%
Adjusted EPS	175.7%	251.4%	113.0%	179.9%	17.7%	50.6%	35.8%	29.6%	23.4%	30.9%
Adjusted EBITDA	172.0%	355.4%	155.0%	73.4%	36.4%	48.3%	36.4%	30.0%	23.6%	34.7%
Profitability (%)										
Gross Margin	71.2%	67.3%	71.8%	74.5%	72.0%	73.0%	74.0%	75.0%	76.0%	74.0%
Operating Margin	38.3%	25.7%	41.8%	47.5%	42.6%	44.3%	46.0%	48.1%	50.2%	46.2%
Net Margin	30.1%	21.1%	24.7%	44.4%	37.1%	39.8%	41.8%	44.2%	46.6%	41.9%
Adjusted EBITDA Margin	41.7%	30.1%	44.5%	50.7%	46.0%	48.6%	51.2%	54.3%	57.4%	51.5%
Return on Equity	49.2%	14.1%	40.6%	92.8%	36.8%	31.2%	31.0%	29.6%	27.5%	31.2%
Adjusted ROIC	37.9%	24.5%	33.8%	55.5%	23.3%	25.2%	25.0%	23.9%	22.2%	23.9%
Adjusted RONIC	14.0%	-102.1%	51.1%	93.0%	3.4%	30.9%	24.4%	20.7%	16.6%	19.2%

Source: Company filngs, Morningstar

About Morningstar® Institutional Equity Research™

Morningstar Institutional Equity Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages, or Economic Moats.

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