

Consumer finance deleveraging clouds 2018 outlook

- We believe there is an increasing likelihood that the fallout in cash loan sector might spread to consumer finance. What might be at risk is Ant Financial's (Ant Fin) balance sheet deleveraging;
- Deleveraging will impact Alibaba's GMV growth in 2018. It might also hurt Baidu's near-term outlook. We cut BABA, JD and BIDU's TP's from US\$190, US\$55 and US\$295 to US\$185, US\$50 and US\$285.

Regulators might require Ant Fin to put up more capital

The December 1st regulation on the cash loan industry required companies to include their asset-backed-securities (ABS) on their balance sheets to calculate leverage ratio. This will affect Ant Fin in particular. At this point it is not clear whether the regulators mean all ABS or just the self-funded portion (which typically <10% of total). The outcome will determine how much additional capital Ant Fin must put up to meet its capital requirement. Either way, we believe Ant Fin will turn cautious in lending next year, leading to slower GMV growth.

Both Ant Fin and JD Finance (JDF) will turn cautious in lending

- (1) We estimate Ant Fin's consumer finance product *Huabei* (花呗) had a balance of RMB300bn and cash loan product *Jiebei* (借呗) RMB230bn as of C3Q17. According to Caixin Media, *Huabei* had RMB195bn and *Jiebei* 178bn ABS outstanding as of December 4, 2017. *Huabei*'s balance on Ant Fin's micro-loan license holder in Chongqing had a balance of RMB99bn as of C2Q17. Yet Ant Fin's registered capital was only RMB12bn, which means if regulators require all ABS balance to be included Ant Fin must put up RMB165bn (US\$25bn) cash assuming 3x leverage ratio. If regulators only require self-funded (estimate 10%) portion then Ant Fin must put up RMB5bn;
- (2) JDF's finance position was disclosed in JD's financial statement as of C3Q17. Consumer finance product *Baitiao* (白条) had a balance of RMB17bn, with an ABS balance (non-securitization-debt) of RMB35bn. Yet JDF's registered capital was only Rmb5bn. Therefore, JDF must put up RMB12bn (US\$1.8bn) assuming 3x leverage ratio if all ABS balance must be included and RMB1.8bn if only self-funded portion must be included for leverage calculations.

In our view the risk is relatively moderate for JDF but more severe for Ant Fin.

Key financial of stock mentioned

(RMB mn)	Revenues			Non-GAAP op.profit		
	2016A	2017E	2018E	2016A	2017E	2018E
Alibaba	100,840	157,518	239,566	48,267	68,417	102,295
JD.com, Inc	258,290	355,277	448,471	2,401	4,246	9,844
Vipshops	56,591	71,875	82,098	3,492	3,514	1,966
Baidu, Inc	70,549	85,521	104,853	11,706	18,990	26,835

Source: Bloomberg, Blue Lotus (as of Dec 26, 2017)

BUY

HOLD

SELL

What has changed

	To	From
Alibaba Group Holdings	US\$185	US\$190
JD.com, Inc.	US\$50	US\$55
Baidu Inc.	US\$285	US\$295

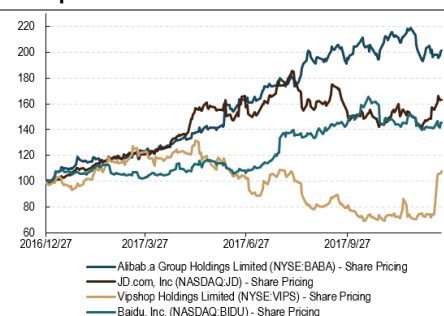
Source: Blue Lotus (as of Dec 26, 2017)

Stocks mentioned

Name	BBG code	Rating	TP	Curr. price	Next yr PE
Alibaba Group Holdings	BABA	BUY	US\$185	176.3	31
JD.com, Inc.	JD	BUY	US\$50	42.1	35
Vipshop Holdings	VIPS	HOLD	US\$15	12.2	21
Baidu, Inc.	BIDU	BUY	US\$285	239.0	16
ZTO Express	ZTO	HOLD	US\$15	15.9	22
Best Inc.	BSTI	BUY	US\$19	9.0	68
SF Express	002352	HOLD	RMB55	51.3	36
YUNDA Express	002120	HOLD	RMB40	46.1	24
YTO Express	600233	SELL	RMB9	16.9	21

Source: Bloomberg, Blue Lotus (as of Dec 26, 2017)

Price performance and volume data



Source: Blue Lotus (as of Dec 26, 2017)

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Blue Lotus Capital Advisors Limited

All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Bloomberg, Blue Lotus Capital Advisors Limited and subject companies. Consensus forward estimates are used in analysis. Past performance is not indicative of future results. Investors should consider this report as only a single factor in making their investment decision.

Alibaba Group Holdings Limited: Financial Summary

Fiscal year ends-31-Mar

Exhibit 1. Income statement

(RMB mn)	F2016A	F2017A	F2018E
China retail market place GMV	3,092,000	3,767,000	4,570,660
Net revenues	100,840	157,518	239,566
Cost of revenues	(34,355)	(59,483)	(94,217)
Gross profit	66,485	98,035	145,349
Operating expenses, GAAP	(37,686)	(50,735)	(76,073)
R&D cost	(13,788)	(17,060)	(25,051)
Sales marketing cost	(11,307)	(16,314)	(24,542)
General administrative	(9,205)	(12,239)	(19,251)
Other items	(3,386)	(5,122)	(7,230)
Operating profit, GAAP	28,799	47,300	69,276
Share based compensation	16,082	15,995	25,789
Operating profit, non-GAAP	48,267	68,417	102,295
Finance cost, net	50,308	5,888	8,736
Other income/cost	2,058	6,086	7,624
Pre-tax profit, GAAP	81,165	59,274	85,636
Income tax	(8,449)	(13,776)	(14,417)
Net income to ordinary shareholders, GAAP	71,157	39,855	65,912
Net income to ordi shareholders, Non-GAAP	45,934	60,972	98,931
Number of ADS, diluted	2,562	2,572	2,582
EPADS, GAAP, diluted	27.77	15.50	25.53
EPADS, non-GAAP, diluted	17.93	23.71	38.32

Source: Alibaba Group Holdings Ltd., Blue Lotus (as of Dec 26, 2017)

Exhibit 2. Balance sheet

(RMB mn)	F2016A	F2017A	F2018E
Cash	106,818	99,825	120,822
Short-term invest. And inv in sec.	8,878	10,878	12,878
Prepayments and others	17,028	29,483	46,698
Total current asset	132,724	140,185	180,398
Property and equipment	13,629	27,141	45,240
Investment in securities, non-current	120,853	189,466	261,729
Land use rights	2,876	8,202	17,496
Intangibles, goodwill and others	87,015	88,373	85,962
Prepayments, non-current	6,007	10,401	16,474
Total assets	364,450	465,164	608,746
Bank borrowings	4,304	4,304	4,304
Income tax payable	2,790	4,279	6,389
Accrued expense	27,334	40,834	64,678
Deferred revenue	10,297	15,297	22,067
Merchant deposits	7,314	11,740	18,334
Total current liabilities	52,039	76,454	115,771
Long term debt	1,871	1,871	1,871
Deferred tax liabilities	9,055	12,692	17,957
Total non-current liabilities	10,926	14,563	19,828
Additional paid in capital	132,206	132,206	132,206
Retained earnings	78,752	134,602	226,303
Total equity	217,337	289,999	397,188
Total liabilities and equity	364,450	465,164	608,746

Source: Alibaba Group Holdings Ltd., Blue Lotus (as of Dec 26, 2017)

Company Description

In 2013, Alibaba Group becomes the largest online mobile e-business company by GMV in the world. Alibaba operate several subsidiaries. Taobao Marketplace, the largest C2C platform in the world whose GMV account for 90% of China's market share. Taobao Mall, the largest B2B2C platform in the world its GMV account for 56% of China's market share. Alibaba Cloud Computing, the largest public cloud computing company in China, occupying 14% market share. Alibaba owns one-third of Ant Finance, including AliPay which is the largest online payment platform in the world occupying 49% market share.

Industry View

We expect China's e-commerce market to grow by 34% in 2016, after growing 44% in 2015. We expect B2C/B2B2C, C2C and O2O sub-sectors to grow 40%, 15% and 100%, respectively to reach 44%, 35% and 14% of the online retail market.

Exhibit 3. Cash flow statement

(RMB mn)	F2016A	F2017A	F2018E
Net income	71,157	39,855	65,912
Adjusted for			
Depreciation & amortization	3,770	5,284	11,035
Share based compensation	12,079	12,102	18,301
Amortization of intangible assets	2,931	5,122	7,230
Changes in			
Loan receivable	835	-	-
Restricted cash and escrow	951	(50)	(50)
Prepayments and others	(5,972)	(16,848)	(23,289)
Income tax payables	57	1,489	2,109
Merchant deposits	113	4,426	6,594
Accrued liabilities and deferred rev.	9,872	18,500	30,614
Cash from operations	28,193	72,106	121,682
Capex, PPE	(9,161)	(14,905)	(21,810)
Purchase of intangibles	3,723	2,685	3,221
Change in short term investments	9,448	(1,000)	(1,000)
Cash paid for equity investment	(37,625)	(48,854)	(63,069)
Cash from Investing activities	(40,872)	(78,827)	(100,449)
Purchase/redemption of debt	31,937	26,314	55,180
Cash from financing activities	36,078	(272)	(236)
Change in cash	(1,375)	(6,993)	20,997
Cash at beginning	108,193	106,818	99,825
Cash at end	106,818	99,825	120,822

Source: Alibaba Group Holdings Ltd., Blue Lotus (as of Dec 26, 2017)

See the last page of the report for important disclosures

JD.com, Inc.: Financial Summary

Fiscal year ends 31-Dec

Exhibit 4. Income statement

(RMB mn)	F2016A	F2017E	F2018E
Gross GMV	658,100	908,658	1,127,423
Net revenues	258,290	355,277	448,471
Cost of revenues	(222,934)	(304,095)	(375,470)
Gross profit	35,356	51,182	73,001
Fulfillment cost	(18,560)	(25,650)	(34,335)
Marketing cost	(10,159)	(15,430)	(21,186)
Technology & content	(4,453)	(6,275)	(8,275)
G&A cost	(3,436)	(4,150)	(4,671)
Operating profit GAAP	(1,251)	(323)	4,533
Share based compensation	2,044	2,793	3,525
Operating profit non-GAAP	2,401	4,246	9,844
Finance cost/income	222	1,543	2,225
Other income/cost	1,758	569	–
Pre-tax profit, GAAP	729	1,789	6,759
Income tax	(180)	(98)	(174)
Net income, GAAP	549	1,690	6,584
Number of ADS, diluted	1,417	1,467	1,487
EPADS, GAAP	0.39	1.15	4.43
Gross margin	13.7%	14.4%	16.3%
Operating margin, non-GAAP	0.9%	1.2%	2.2%
Net margin, GAAP	0.2%	0.5%	1.5%

Source: JD.com, Inc., Blue Lotus (as of Dec 26, 2017)

Exhibit 5. Balance sheet

(RMB mn)	F2016A	F2017E	F2018E
Cash and cash equivalent	19,772	70,065	102,266
Restricted cash and ST investment	11,566	11,566	11,566
Accounts receivable	17,464	24,509	31,552
Inventory, net	28,909	39,442	48,710
Prepayments and others	3,609	3,025	3,818
Total current asset	106,932	152,058	201,790
Property and equipment	7,397	9,728	12,833
Construction in progress	1,992	1,650	1,637
Land use rights	2,448	5,763	2,843
Intangibles, goodwill and others	42,054	28,734	29,771
Total assets	160,823	205,992	256,931
Account payables	43,988	60,219	82,448
Advance from customers	11,633	16,001	20,198
Accrued expense and others	31,499	44,156	57,062
Short term debt	8,333	8,333	8,333
Total current liabilities	95,454	128,709	168,041
Long term debt	14,665	16,216	18,070
Ordinary and preferred share	–	0	0
Additional paid in capital	59,258	59,458	59,558
Statutory reserves	(5,049)	–	–
Accumulative deficit/loss	(20,221)	(10,847)	(458)
Total equity	33,988	48,611	59,101
Total liabilities and equity	160,823	205,991	256,931

Source: JD.com, Inc., Blue Lotus (as of Dec 26, 2017)

Company Description

JD.com is China's largest direct B2C retailer, second largest B2Cretailer and China's 5th largest retailer by GMV. In 2014, 97mn (+105% YoY) customers placed 689mn orders (+113% YoY) on JD.com, generating gross GMV of RMB 260bn (107% YoY).

Industry View

We expect China's online retail market to grow by 34% in 2016, after growing 44% in 2015. We expect B2C/B2B2C, C2C and O2O sub-sectors to grow 40%, 15% and 100%, respectively to reach 44%, 35% and 14% of the online retail market.

Exhibit 6. Cash flow statement

(RMB mn)	F2016A	F2017E	F2018E
Net income	549	1,690	6,584
Adjusted for			
Depreciation & amortization	3,633	5,846	7,029
Share based compensation	2,044	2,793	3,525
Allowance for doubtful accounts	867	1,228	1,595
One-time write-offs	164	–	–
Changes in			
Account receivable	(8,824)	(8,273)	(8,639)
Inventory	(8,369)	(10,533)	(9,268)
Account payables	14,169	16,231	22,229
Advance to customers and to suppliers	3,962	3,833	3,684
Accrued liabilities and deferred revenues	18,341	13,241	12,113
Cash from operations	26,536	26,058	38,852
Capex, PPE	(3,731)	(3,930)	(4,876)
Capex, land and bldg.	(678)	(200)	(500)
Purchase of intangibles	(50)	(69)	(88)
Purchase of short term investments	(4,231)	–	–
Cash paid for equity investment	(7,626)	(100)	(100)
Purchase/issuance of company shares	13,105	–	–
Purchase/redemption of debt	18,443	–	–
Cash from financing	19,936	–	–
Change in cash	30,650	21,552	32,201
Cash at beginning	17,864	48,514	70,065
Cash at end	48,514	70,065	102,266

Source: JD.com, Inc., Blue Lotus (as of Dec 26, 2017)

See the last page of the report for important disclosures

Vipshop Holdings Limited: Financial Summary

Fiscal year 31-Dec

Exhibit 7. Income statement

(RMB mn)	F2016A	F2017E	F2018E
Net revenues	56,591	71,875	82,098
Cost of revenues	(42,995)	(55,717)	(64,509)
Gross profit	13,597	16,157	17,589
Fulfilment cost	(4,905)	(6,980)	(8,747)
Sales marketing cost	(2,838)	(3,010)	(3,198)
Tech & content cost	(1,564)	(1,953)	(2,434)
G&A cost	(1,941)	(2,485)	(3,042)
Other income/cost	358	658	986
Operating profit GAAP	2,708	2,388	1,156
Share based compensation	476	786	473
Operating profit non-GAAP	3,492	3,514	1,966
Finance income (cost)	22	14	48
Other income/cost	(135.0)	(204.4)	(4.0)
Pre-tax profit	2,595	2,197	1,199
Income tax	(602)	(562)	(327)
Net income, GAAP	1,993	1,635	872
Number of ADS, diluted	610	612	622
EPADS, GAAP	3.27	2.67	1.40
EPADS, non-GAAP	4.74	4.68	2.71
Gross margin	24.0%	22.5%	21.4%
Operating margin, non-GAAP	6.2%	4.9%	2.4%
Net margin, GAAP	3.5%	2.3%	1.1%

Source: Vipshop Holdings Limited, Blue Lotus (as of Dec 26, 2017)

Company Description

Vipshop (VIPS) is China's leading online discount retailer and largest flash sale retail operator, occupying more than 50% market share in flash sale market. The registered members of Vipshop had exceed 100 million in 2014. More than 13,000 brands have sold their discounted products on Vipshop.

Industry View

Off-season apparel market is estimated to account for 20% of total apparel sales. We estimate this market can reach RMB400bn.

Exhibit 8. Balance sheet

(RMB mn)	F2016A	F2017E	F2018E
Cash and cash equivalent	4,110	5,061	4,580
Restricted cash & HTM securities	672	1,172	1,672
Account receivable	2,334	2,956	3,372
Inventory	4,949	6,076	6,711
Other receivables	2,294	2,905	3,314
Total current assets	14,581	18,453	19,970
Property and equipment	4,467	6,576	8,284
Deposit for PPE	1,040	1,376	1,589
Land use rights	2,399	2,499	2,549
Intangible assets	725	170	266
Other long term assets	511	511	511
Total assets	25,094	28,904	32,392
Account payables	8,334	9,578	10,206
Advance from customers	2,700	3,346	3,521
Accrued liabilities	3,323	4,229	4,720
Short term debt	0	0	0
Total current liabilities	14,583	17,449	18,788
Convertible debt	4,382	4,382	4,382
Additional paid in capital	3,130	3,130	3,130
Treasury stock	(707)	(68)	(132)
Retailed earnings	3,653	5,288	6,161
Accumulative deficit/loss	(344)	(1,624)	(284)
Total equity	5,782	6,726	8,875
Total liabilities and equity	25,094	28,904	32,392

Source: Vipshop Holdings Limited, Blue Lotus (as of Dec 26, 2017)

Exhibit 9. Cash flow statement

(RMB mn)	F2016A	F2017E	F2018E
Net income	1,993	1,635	872
Adjusted for Share based compensation			
Depreciation	476	786	473
Amortization	291	481	735
Inventory write off	290	289	287
Changes in	294	386	454
Account receivable			
Other receivables	(1,982)	(622)	(416)
Inventory	(424)	(611)	(408)
Account payables	(382)	(1,127)	(635)
Advance from customers	1,688	1,245	628
Accrued liabilities	690	646	175
Cash from operations	218	907	491
Capex	3,373	4,360	3,002
Cash paid for land	(1,968)	(2,317)	(2,443)
Purchase of HTM securities	(2,202)	(100)	(50)
Cash from investing	(500)	(500)	(500)
Purchase/Repurchase of company shares	(3,734)	(3,408)	(3,484)
Issuance of convertible bond	(95)	0	0
Cash from financing	324	0	0
Change in cash	229	0	0
Cash at beginning	785	952	(482)
Cash at end	3,324	4,110	5,061

Source: Vipshop Holdings Limited, Blue Lotus (as of Dec 26, 2017)

See the last page of the report for important disclosures

Will consumer finance cease to be a GMV support next year?

- **Crackdown on the cash loan industry might spill-over to consumer finance:** Ant Fin's loan balance only stood at RMB30bn in C1Q16. It grew 16x in two years. If we assume *Huabei's* balance grew by RMB150bn in 2017 and loan duration is 1 month, then loan origination would have been RMB1.8tn, comparing to BABA's GMV of ~RMB4.3tn in calendar 2017. We believe many of *Huabei's* balance addition is New Retail transactions, which have not yet been included in BABA's GMV. However, it is almost certain, in our view, that (1) both BABA and JD will reduce their GMV reliance on consumer finance next year, (2) New Retail GMV has questionable take rate potentials. JDF has been less aggressive in pursuing credit expansion than Ant. *Baitiao* and its corresponding ABS grew by RMB11bn in 2017, which would have translated to RMB121bn in GMV, or 13% of JD's 2017 GMV (pre-restatement);
- **Disaster scenario is unlikely:** We believe the regulators will likely permit the inclusion of only the self-funded portion of ABS in the calculation of leverage ratios. The self-funded portion of ABS is purchased by the issuer (Ant Fin and JDF) itself, likely due to low credit quality. However, if the regulators view the co-purchasers of ABS to have poor risk control capability they might require the issuers to take up the entire balance on their balance sheets to compensate for the risk;
- **Ant Fin and JDF likely have minimum regulatory risk:** Unlike cash loan providers, Ant Fin and JDF charge very reasonable interest rates to the borrowers (*Huabei* =16%, *Jiebei* =18%, *Baitiao*=11%). Their regulatory risk is very low, in our view, from the standpoint of social impact. Most e-commerce transactions also have scenario support. Regulator, however, might be weary of extending credit to so many new borrowers so quickly. We believe *Huabei*, *Jiebei* and *Baitiao* are all credit card-type products, but extending to borrowers either without a credit card, or borrowing beyond credit card limits. The spread of online consumer finance accelerates offline GMV's migration online, in our view;
- **Poor iPhone 8 and X sales hurt JD:** While we applaud JDF's prudent credit policy comparing to Ant Fin we are cautioned by the potential harm to big ticket home appliance merchandises in case JDF starting to shrink its balance sheet next year. JD benefited from increasing ASP of its merchandises which inevitably have to do with consumer finance to some degree. Further, online sales of iPhone currently account for 5-13% of JD's revenues, with iPhone accounting for 1/3. iPhone 8 sales has been disappointing while iPhone X only had one month of sales in C4Q. As a result we estimate smartphone sales only grew 25% QoQ in C4Q, below our overall GMV growth estimate of 28% QoQ;
- **Decreasing financial category advertisement hurt Baidu:** We estimate the total micro loan origination to be RMB3.6tn (loan balance RMB300bn). The average customer acquisition cost of micro loan industry is 5% and the micro loan industry has a repeat borrow ratio about 65%. We believe about RMB63bn will be used for adverting, mostly on TV. But since financial is one of Baidu's top 3 advertisement categories, we think it is also prudent to turn cautious on Baidu's advertising outlook;

Huabei and Jiebei are key drivers to BABA's GMV growth. BABA's GMV is more reliant on consumer finance than JD is, in our view.

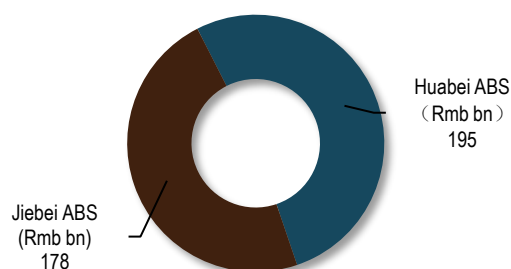
Huabei, Jiebei and Baitiao cannibalize credit card to some degree. They accelerate offline GMV's migration online.

Our channel check suggests Toutiao and Baidu are also cash loan advertising destinations.

- **Further cut in delivery outlook possible:** We currently forecast 2018 parcel volume growth of 23% YoY, down from 2017's 28%. Our GMV estimate for both BABA and JD are below parcel growth. If further cut in delivery parcel is warranted, SFE and BSTI are the best positioned thanks to their diversified product lines. ZTO, YUNDA and YTO are the worst affected;
- **VIPS only has RMB800mn ABS outstanding:** Similar to JD VIPS has small consumer finance balances of RMB3.6bn on its balance sheet and RMB800mn on ABS, or 8.4% of JD's level. We estimate VIPS's 2017 GMV to be RMB100bn. This means VIPS's credit exposure is below JDF's and also below Ant Fin's.

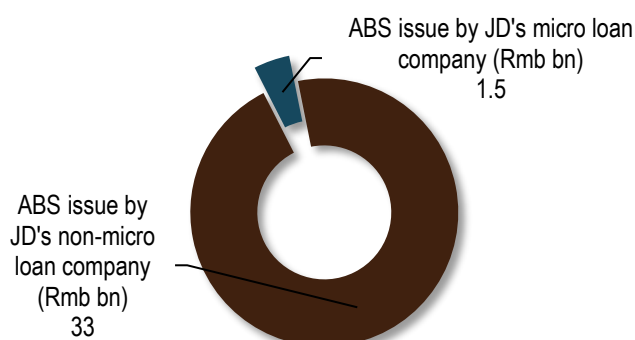
VIPS's GMV reliance on consumer finance was 4.4% in 2017.

Exhibit 10. Distribution of ABS issued by Ant Finance



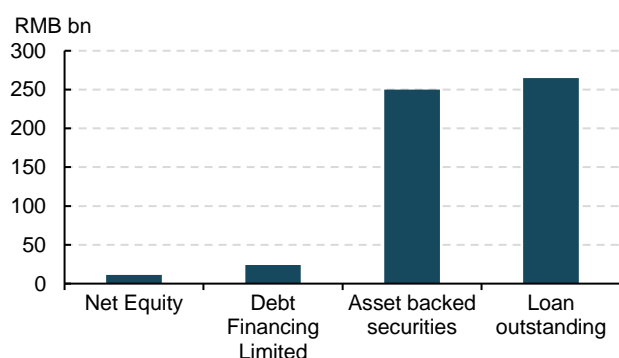
Source: Caixin Media, China Securitization Analytics, Blue Lotus (as of Dec 26, 2017)

Exhibit 11. Distribution of ABS issued by JD Finance



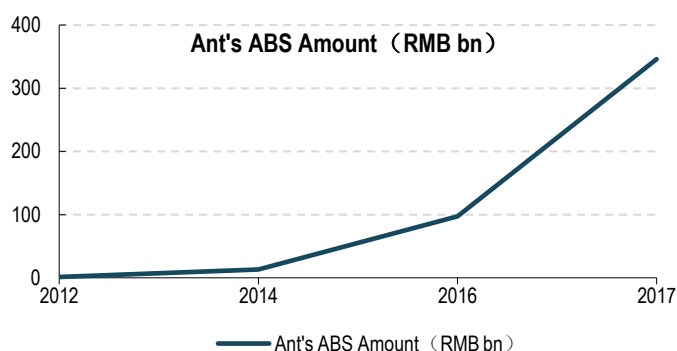
Source: Caixin Media, China Securitization Analytics, Blue Lotus (as of Dec 26, 2017)

Exhibit 12. The Data of Ant Finance



Source: Caixin Media, China Securitization Analytics, Blue Lotus (as of Dec 26, 2017)

Exhibit 13. The Growth of Ant Finance's ABS



Source: Caixin Media, China Securitization Analytics, Blue Lotus (as of Dec 26, 2017)

Exhibit 14. Overall performance of Alibaba's double 11 shopping carnival

	4Q16	1Q17	2Q17	3Q17	Total
iPhone sales volume in China (mn)	19	35	57	91	121
Estimates					
iPhone sales on JD (RMB mn)	14,006	7,258	6,370	5,940	33,574
Revenue generated for JD (RMB mn)	10,676	5,552	4,884	4,549	25,661
JD's quarterly revenue (RMB mn)	80,254	76,226	93,202	83,746	333,427
% of revenue contributed by iPhone	13.3%	7.3%	5.2%	5.4%	7.7%
iPhone sales on JD (RMB mn)	14,006	7,258	6,370	5,940	33,574

Source: IDC, GFK, Blue Lotus (as of Dec 26, 2017)

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Equity rating allocation as of December 4, 2017

Buy	58%	Hold	38%	Sell	4%
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Blue Lotus rating system:

Buy : The stock is expected to have an absolute return of more than 15-20% within 12 months

Hold: The stock is expected to have an absolute return of between 0-15% within 12 months

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