Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

A powerful network effect in a rapidly growing industry makes wide moat-rated Alibaba a rare find.

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Research as of 22 Sep 2014
Estimates as of 17 Sep 2014
Pricing data through 22 Sep 2014
Rating updated as of 22 Sep 2014

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 22 Sep 2014

By operating some of the world's largest online marketplaces, Alibaba benefits from a strong network effect in the rapidly growing e-commerce industry in China. The firm has played a prominent role in China's structural transition to online shopping from brick-and-mortar retail the past decade. Alibaba's three major marketplaces--Taobao, Tmall, and Juhuasuan--together generated a gross merchandise volume, or GMV, of CNY1.542 trillion (USD 248 billion) in calendar 2013, more than Amazon and eBay combined (USD 116 billion and USD 88 billion, respectively). 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 and 8.5 million active sellers as of June 30, 2014.

As China's e-commerce market rapidly shifting from C2C to B2C, we believe Taobao will be instrumental in helping Alibaba adapt to changes in China's e-commerce landscape. Taobao's dominant network effect enhances Alibaba's entire ecosystem, providing low-cost organic traffic for Tmall and other B2C marketplaces while reducing a reliance on a salesforce for marketing services, also providing Alibaba additional cost advantages.

Alibaba's success with desktop transactions also gives the company key advantages against its competitors on the mobile end. Its trusted brand and self-reinforcing ecosystem convince us that the firm can copy its success to the mobile commerce market. Taobao's mobile app is already China's most popular mobile commerce app by user base. 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.

We expect the firm to benefit from several macroeconomic, socioeconomic, and industry tailwinds. Continuous wealth creation and steady income growth among China's middle classes should enlarge the wallet share of users on Alibaba's marketplaces. The relatively young user profile ensures the longevity of its network effect, while further penetration of broadband and mobile devices will fuel the user growth and increased monetization rates.

Vital Statistics

Market Cap (USD Mil)	221,579
52-Week High (USD)	99.70
52-Week Low (USD)	89.50
52-Week Total Return %	—
YTD Total Return %	—
Last Fiscal Year End	31 Mar 2014
5-Yr Forward Revenue CAGR %	31.4
5-Yr Forward EPS CAGR %	31.0
Price/Fair Value	1.00

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Price/Earnings	—	—	*46.8*	*31.1*
EV/EBITDA	—	—	*37.5*	*25.3*
EV/EBIT	—	—	*40.5*	*27.8*
Free Cash Flow Yield %	—	—	*2.7*	—
Dividend Yield %	—	—	—	—

Financial Summary and Forecasts (CNY Mil)

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Revenue	34,517	52,504	*78,924*	*110,810*
Revenue YoY %	72.4	52.1	*50.3*	*40.4*
EBIT	14,413	24,964	*33,619*	*49,100*
EBIT YoY %	179.9	73.2	*34.7*	*46.1*
Net Income, Adjusted	8,532	23,315	*29,320*	*44,157*
Net Income YoY %	101.8	173.3	*25.8*	*50.6*
Diluted EPS	0.58	1.63	*1.92*	*2.89*
Diluted EPS YoY %	113.0	179.9	*17.7*	*50.6*
Free Cash Flow	15,003	-6,321	*29,623*	*41,897*
Free Cash Flow YoY %	164.5	-142.1	*-568.6*	*41.4*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Alibaba is the world's largest online and mobile commerce company by gross merchandise volume. It operates some of China's most popular online shopping destinations, including Taobao (C2C), Tmall (B2C), and Juhuasuan (group buying). These three marketplaces generated a combined gross merchandise volume of CNY 1.833 trillion (USD 296 billion) in the twelve months ended June 30, 2014. Its China retail marketplaces possess 279 million active buyers (more than 20% of the Chinese population) and 8.5 million active sellers as of June 30, 2014.

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Morningstar Analysis

Valuation, Growth and Profitability 22 Sep 2014

We are initiating coverage of Alibaba with a fair value estimate of USD 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 in China will all contribute to Alibaba's online retail revenue growth. 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, aided by GMV from the B2C marketplace and a steady increase in mobile monetization rates.

Although the firm has undeniable operating leverage potential, we believe continuously intense competition from other e-commerce rivals will force Alibaba to continue investing in technology infrastructure, traffic acquisition, and personnel. We therefore expect some margin contraction over the near term, with gross margins declining to 72.0% in fiscal 2015 and operating margins compressing to 43.0% because of technology, product development, and marketing investments (compared with 74.5% and 47.5% in fiscal 2014). However, we expect roughly 100 basis points of expense leverage annually in the next five years, bringing our 2018 gross and operating margin estimates to 76.0% and 50.2%, respectively.

Our fair value 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, well above our estimated cost of capital and supporting our wide moat rating. Our fair value implies a fiscal 2015 price/earnings ratio of 47 times and forward a fiscal 2016 price/earnings ratio of 35 times. We acknowledge that our valuation appears lofty using traditional multiple-based methodologies, but given Alibaba's tremendous ability to generate cash, promising business prospects, and dominant position in one of the fastest-growing e-commerce industries in the world, we believe Alibaba deserves a premium valuation.

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 rates. 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

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Price/Fair Value Morningstar data as of Sep 22, 2014

scenario is USD 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 USD 65 per ADS.

Economic Moat

We have assigned Alibaba a wide economic moat rating, largely due to a strong network effect, where the value of the platform to consumers increases with a greater number of sellers, and vice versa.

Alibaba's network effect is unusual, having been established in a category (China e-commerce) that we expect to have a very long growth runway based on consumer disposable income and consumption trends, Internet adoption levels, and a highly fragmented retail market. This is in contrast to many other industries, which have often reached a more mature state by the time leading players establish a meaningful network effect. Below, we examine Alibaba's network effect in greater detail and demonstrate how this moat source will drive profitable growth over an extended horizon.

Alibaba's "ecosystem" is made up of three leading Chinese online retailing platforms: (1) Taobao Marketplace, China's largest online C2C shopping site; (2) Tmall, China's largest third-party B2C platform for branded goods; and (3) Juhuasuan, China's most popular group buying marketplace by monthly active users. These three marketplaces accounted for 81.6% of revenue in fiscal 2014, with the remainder coming from Alibaba's China wholesale sites, international commerce, cloud computing, and other services.

These marketplaces generated a combined GMV of CNY 1.542 trillion (USD 248 billion) in calendar 2013, representing 84% of China's CNY 1.841 trillion online shopping industry, according to iResearch, and 7.9% of total consumer expenditures, using data from Euromonitor. This is slightly more than in the U.S., where online purchases in 2013 (USD 264 billion) represented 6% of all retail sales (USD 4.5 trillion), according to retail trade data from the U.S. Census Bureau.

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 product selections, while Taobao users with a strong appetite for branded products could switch to Tmall for a better shopping experience and higher quality assurance. 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.

By operating China's two most popular online shopping sites, we also believe Alibaba has developed a powerful brand intangible asset moat source. Millions of Chinese consumers consider Taobao and Tmall as their default, "go-to" options when seeking products and services online. According to CNNIC's 2013 online shopping survey, more than 70% of online shoppers in China consider either Taobao or Tmall as their most frequently used online marketplace. Additionally, a 2011 survey from iResearch suggests that more than 30% of Taobao users started their online purchase by directly going to Taobao's site, compared with about 1% who started with a search engine. This indicates that Alibaba's marketplaces are increasingly becoming the starting point for online purchases in China, reinforcing both our network effect and intangible asset moat sources.

Moat Trend

We view Alibaba's moat trend as stable. Taobao has already achieved a dominant position in China's online retail market. Millions of buyers and sellers rely on Taobao to stay connected with each other, and we expect its scalability and technology advantages should help the company defend its wide economic moat over the long haul. Taobao's business strategy as a third-party platform means that it co-operates, rather than competes with, merchants, making it an especially appealing destination for millions of retailers. Given the low penetration rate of Internet users and online shopping in China—roughly 45.8% of China's population are Internet users compared with approximately 83.2% in the U.S., with 48.9% of the Internet population shopping online versus 74.2% in the U.S.—we believe there is an opportunity for the network effect to strengthen as incremental third-party sellers distribute their products through Taobao.

Compared with Taobao, Tmall is a relative newcomer. In China, the online selling of branded goods (B2C) is a more fragmented market compared with the broader online retail space, which Taobao dominates. Tmall occupies 52% market share in China's B2C e-commerce market. We view JD.com, which controls approximately 7% of the Chinese online shopping market and 18% of the B2C market in 2013, as one of Tmall's only credible competitors over the long term. According to company filings, JD.com achieved a gross merchandise volume of USD 21 billion in 2013, trailing Tmall's USD 56 billion, according to iResearch. However, we believe the interplay between Taobao and Tmall (as well as Alibaba's other e-commerce marketplaces) will help the company successfully navigate China's shift from C2C to B2C marketplaces, neutralizing the competitive threat from JD.com and other emergent rivals in the process.

In our view, JD's competitive strengths lie in its scale, fulfillment capability, and strategic partnerships in the social network space. 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 Chinese counties and 622 districts, making

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Morningstar Analysis

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.

In spite of the fulfillment infrastructure, we believe JD also possesses a few disadvantages, supporting our view that the company will not gain ground on Tmall in the foreseeable future. First, 85% of JD's top line comes from sales of consumer electronics at thin margins to convince customers to order products online instead of from brick-and-mortar retailers. This explains why JD still hadn't achieved break-even profits in 2013. More importantly, 70% of JD's revenue comes from selling products from its own inventory, while Tmall is primarily a platform operator. In other words, JD competes directly with third-party sellers on its own platform, making it a less attractive destination for sellers. In contrast, Tmall possesses the largest number of branded merchants and, as a result, a stronger network effect. We believe that Tmall's network effect, which is built on its large selections of global and domestic brands, will not be easy for JD to replicate over the long term.

China's mobile commerce is growing at an explosive clip (a five-year GMV CAGR of 290% between 2008 and 2013, based on iResearch data). China has the world's largest mobile Internet base, with 500 million users (37% of the total population). While smartphones and tablets have already been disruptive and disintermediating technologies across several industries, we believe it is evident that Alibaba's network effect has transitioned successfully to mobile devices. Taobao represented 76.2% of mobile retail GMV (excluding virtual items) in China during fiscal 2014 and mobile purchases represent 19.7% of the company's total GMV (CNY 232 billion, or USD 37 billion), demonstrating that Alibaba has established itself as one of the clear leaders in this rapidly expanding field. For comparison's sake, Amazon generated approximately USD 8 billion in revenue from mobile device sales during 2013 (based on estimates from Internet Retailer) while eBay management noted that it facilitated USD 22 billion in mobile gross merchandise volumes and processed USD 27 billion in mobile payments during 2013. This provides additional perspective about Alibaba's ability to bolster its network effect through mobile devices and reinforces our stable moat trend rating.

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Bulls Say/Bears Say

Bulls Say

- Alibaba has only 279 million active buyers as of June 2014, representing 20% of China's population. We expect a long runway of user growth in the coming years.
- The company is strongly positioned to benefit from the structural shift from C2C to B2C in China's e-commerce market, as Tmall can gain significant organic use traffic from Taobao in an extremely cost-effective manner.
- Almost 70% of Chinese online shoppers born in the 1990s consider Taobao as their first online shopping choice. Their loyalty and user habit suggest a lifetime of potential transactions ahead.

Bears Say

- The firm has invested in some businesses that might not significantly improve its ecosystem. This could distract management or result in poor allocation of capital.
- Despite its dominance in China, we believe the road to overseas expansion will be an uphill battle for Alibaba due to the network effects of e-commerce rivals in other regions.
- Rapid expansion of other e-commerce players like JD.com, VipShop, and Amazon could limit the growth potential of Alibaba in some specific product areas and offering expansions.

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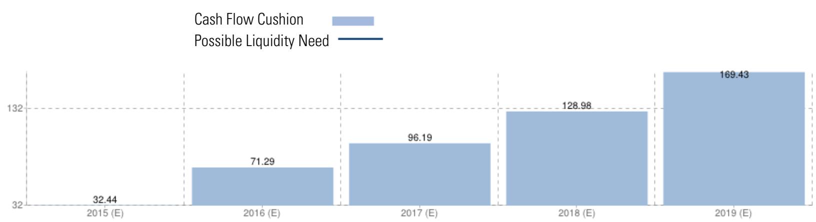
Credit Analysis

Five Year Adjusted Cash Flow Forecast (CNY Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	43,632	123,827	167,468	227,136	306,609
Adjusted Available Cash Flow	36,326	51,866	69,583	90,730	110,940
Total Cash Available before Debt Service	79,958	175,693	237,051	317,867	417,549
Principal Payments	—	—	—	—	—
Interest Payments	-2,465	-2,465	-2,465	-2,465	-2,465
Other Cash Obligations and Commitments	—	—	—	—	—
Total Cash Obligations and Commitments	-2,465	-2,465	-2,465	-2,465	-2,465

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	CNY Millions	% of Commitments
Beginning Cash Balance	43,632	354.1
Sum of 5-Year Adjusted Free Cash Flow	359,445	2,917.0
Sum of Cash and 5-Year Cash Generation	403,077	3,271.1
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	403,077	3,271.1
Sum of 5-Year Cash Commitments	-12,323	—

Credit Rating Pillars–Peer Group Comparison

	BABA	Sector	Universe
Business Risk	4		
Cash Flow Cushion	1	—	—
Solvency Score	2	—	—
Distance to Default	2	—	—
Credit Rating	—	—	—

Source: Morningstar Estimates

Note: Scoring is on a scale 1-10, 1 being Best, 10 being Worst

Financial Health & Capital Structure

Alibaba is in excellent financial health. As of June 2014, the company has CNY 52 billion in cash and cash equivalents against CNY 13 billion in debt. As Alibaba is now going through an investment phase, we believe the company will invest heavily in technology infrastructure, research, marketing, and user acquisition while acquisitions that could further improve Alibaba’s ecosystem including social network, online-to-offline, offline retail and logistic network are also on the cards

Given its enormous cash pile and strong cash-generating capability, we believe the firm should have no problem funding its growth plans, as it can also take advantage of the low borrowing rates on the market from time to time and introduce a bit more debt into its capital structure. In addition, we would like to see the company rewarding its shareholders through either cash dividends or shares buyback upon the initial public offering.

Enterprise Risk

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. In Alibaba's case, we expect the company to face elevated competition, increased regulatory risk, and the threat of ancillary businesses diverting management's attention away from its core marketplaces business.Our major concern comes from the heightened competition in the e-commerce industry 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. Additionally, Alibaba faces competition from VipShop, Amazon, and Suning. These companies might not have sufficient scale to compete

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Credit Analysis

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.Alibaba is also subject to increased online and mobile payment regulatory scrutiny. 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.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.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
First Trust US IPO Fund	—	2.89	164	19 Sep 2014

Concentrated Holders	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
First Trust US IPO Fund	—	2.89	164	19 Sep 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
First Trust Advisors L.P.	—	2.89	164	19 Sep 2014

Top 5 Sellers				
NA	NA	NA	NA	NA

Management 22 Sep 2014

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 execution capabilities, we have concerns regarding Alibaba's corporate governance, which is reflected in our Poor equity 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.

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.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in March

Growth (% YoY)	3-Year Hist. CAGR	2012	2013	2014	*Forecast* 2015	2016	5-Year Proj. CAGR
Revenue	*64.0*	68.2	72.4	52.1	*50.3*	*40.4*	*31.4*
EBIT	*166.3*	289.6	179.9	73.2	*34.7*	*46.1*	*32.8*
EBITDA	*172.1*	355.4	155.0	73.4	*36.4*	*48.3*	*34.7*
Net Income	*170.1*	257.4	101.8	173.3	*25.8*	*50.6*	*32.7*
Diluted EPS	*175.7*	251.4	113.0	179.9	*17.7*	*50.6*	*31.0*
Earnings Before Interest, after Tax	*233.5*	573.9	112.8	158.6	*9.9*	*44.9*	*26.9*
Free Cash Flow	*-305.3*	677.0	164.5	-142.1	*-568.6*	*41.4*	—

Profitability	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Operating Margin %	*38.3*	25.7	41.8	47.6	*42.6*	*44.3*	*46.3*
EBITDA Margin %	*41.7*	30.1	44.5	50.7	*46.0*	*48.6*	*51.5*
Net Margin %	*30.1*	21.1	24.7	44.4	*37.2*	*39.9*	*41.9*
Free Cash Flow Margin %	*19.9*	28.3	43.5	-12.0	*37.5*	*37.8*	*40.4*
ROIC %	*28.4*	15.6	24.8	44.7	*21.3*	*23.6*	*22.7*
Adjusted ROIC %	*37.9*	24.5	33.8	55.5	*23.3*	*25.2*	*23.9*
Return on Assets %	*17.3*	9.9	15.4	26.6	*18.4*	*18.5*	*19.1*
Return on Equity %	*49.2*	14.1	40.6	92.8	*36.8*	*31.2*	*31.2*

Leverage	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Debt/Capital	*0.42*	0.04	0.73	0.51	*0.26*	*0.20*	*0.17*
Total Debt/EBITDA	*1.19*	0.21	1.82	1.54	*1.13*	*0.76*	*0.65*
EBITDA/Interest Expense	*36.81*	88.53	9.76	12.13	*14.73*	*21.85*	*30.60*

Valuation Summary and Forecasts

	2013	2014	*2015(E)*	*2016(E)*
Price/Fair Value	—	—	—	—
Price/Earnings	—	—	*46.8*	*31.1*
EV/EBITDA	—	—	*37.5*	*25.3*
EV/EBIT	—	—	*40.5*	*27.8*
Free Cash Flow Yield %	—	—	*2.7*	—
Dividend Yield %	—	—	—	—

Key Valuation Drivers

Cost of Equity %	10.0
Pre-Tax Cost of Debt %	5.0
Weighted Average Cost of Capital %	9.7
Long-Run Tax Rate %	15.0
Stage II EBI Growth Rate %	8.0
Stage II Investment Rate %	16.0
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	CNY Mil	Firm Value (%)	Per Share Value
Present Value Stage I	213,755	16.1	81.52
Present Value Stage II	623,666	46.9	237.83
Present Value Stage III	491,864	37.0	187.57
Total Firm Value	**1,329,285**	**100.0**	**506.92**
Cash and Equivalents	48,553	—	18.52
Debt	-41,075	—	-15.66
Preferred Stock	—	—	—
Other Adjustments	50,406	—	19.22
Equity Value	**1,387,169**	**—**	**528.99**
Projected Diluted Shares	2,622		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Income Statement (CNY Mil)
Fiscal Year Ends in March

				Forecast	
	2012	2013	2014	*2015*	*2016*
Revenue	**20,025**	**34,517**	**52,504**	***78,924***	***110,810***
Cost of Goods Sold	6,554	9,719	13,369	*22,099*	*29,919*
Gross Profit	**13,471**	**24,798**	**39,135**	***56,825***	***80,891***
Selling, General & Administrative Expenses	5,269	6,502	8,763	*13,417*	*18,616*
Research & Development	2,897	3,753	5,093	*9,471*	*12,854*
Other Operating Expense (Income)	—	—	—	—	—
Depreciation & Amortization (if reported separately)	155	130	315	*318*	*321*
Operating Income (ex charges)	**5,150**	**14,413**	**24,964**	***33,619***	***49,100***
Restructuring & Other Cash Charges	—	3,487	—	—	—
Impairment Charges (if reported separately)	135	175	44	—	—
Other Non-Cash (Income)/Charges	-327	-894	-2,429	*-784*	*-900*
Operating Income (incl charges)	**5,342**	**11,645**	**27,349**	***34,403***	***50,000***
Interest Expense	68	1,572	2,195	*2,465*	*2,465*
Interest Income	258	39	1,648	*2,660*	*4,517*
Pre-Tax Income	**5,532**	**10,112**	**26,802**	***34,598***	***52,053***
Income Tax Expense	842	1,457	3,196	*5,190*	*7,808*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	-25	-6	-203	—	—
(Minority Interest)	-437	-117	-88	*-88*	*-88*
(Preferred Dividends)	—	—	—	—	—
Net Income	**4,228**	**8,532**	**23,315**	***29,320***	***44,157***
Weighted Average Diluted Shares Outstanding	2,522	2,389	2,332	*2,491*	*2,491*
Diluted Earnings Per Share	**1.68**	**3.57**	**10.00**	***11.77***	***17.73***
Adjusted Net Income	4,228	8,532	23,315	*29,320*	*44,157*
Diluted Earnings Per Share (Adjusted)	**1.68**	**3.57**	**10.00**	***11.77***	***17.73***
Dividends Per Common Share	—	—	—	—	—
EBITDA	**6,212**	**12,580**	**29,003**	***37,085***	***54,748***
Adjusted EBITDA	**6,020**	**15,348**	**26,618**	***36,302***	***53,847***

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Balance Sheet (CNY Mil)

Fiscal Year Ends in March

				Forecast	
	2012	2013	2014	*2015*	*2016*
Cash and Equivalents	21,744	32,686	43,632	*123,827*	*167,468*
Investments	3,312	3,687	4,921	*4,921*	*4,921*
Accounts Receivable	581	5,055	14,601	*21,839*	*30,359*
Inventory	—	—	—	—	—
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	2,262	1,734	4,679	*7,033*	*9,875*
Current Assets	**27,899**	**43,162**	**67,833**	***157,620***	***212,623***
Net Property Plant, and Equipment	2,463	3,808	5,581	*9,938*	*14,089*
Goodwill	11,436	11,294	11,793	*11,793*	*11,793*
Other Intangibles	2,056	2,229	3,566	*3,765*	*4,042*
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	1,466	1,496	2,087	*3,137*	*4,405*
Long-Term Non-Operating Assets	1,890	1,797	20,689	*21,473*	*22,373*
Total Assets	**47,210**	**63,786**	**111,549**	***207,727***	***269,324***
Accounts Payable	4,659	8,961	11,887	*19,649*	*26,602*
Short-Term Debt	1,283	5,448	10,364	*10,364*	*10,364*
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	5,809	9,586	15,133	*22,748*	*31,938*
Current Liabilities	**11,751**	**23,995**	**37,384**	***52,761***	***68,904***
Long-Term Debt	—	22,462	30,711	*30,711*	*30,711*
Deferred Tax Liabilities (Long-Term)	413	643	2,136	*3,211*	*4,508*
Other Long-Term Operating Liabilities	—	—	—	—	—
Long-Term Non-Operating Liabilities	633	5,640	500	*500*	*500*
Total Liabilities	**12,797**	**52,740**	**70,731**	***87,183***	***104,623***
Preferred Stock	—	—	—	—	—
Common Stock	30	10,533	10,401	*10,401*	*10,401*
Additional Paid-in Capital	20,778	21,655	27,043	*77,449*	*77,449*
Retained Earnings (Deficit)	12,552	-20,491	1,183	*30,503*	*74,660*
(Treasury Stock)	—	—	—	—	—
Other Equity	-1,842	-1,188	1,112	*1,112*	*1,112*
Shareholder's Equity	**31,518**	**10,509**	**39,739**	***119,465***	***163,622***
Minority Interest	2,895	537	1,079	*1,079*	*1,079*
Total Equity	**34,413**	**11,046**	**40,818**	***120,544***	***164,701***

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Cash Flow (CNY Mil)
Fiscal Year Ends in March

				Forecast	
	2012	2013	2014	*2015*	*2016*
Net Income	4,665	8,649	23,403	*29,408*	*44,245*
Depreciation	715	805	1,339	*2,368*	*4,432*
Amortization	155	130	315	*315*	*315*
Stock-Based Compensation	1,254	1,259	2,844	*4,354*	*6,042*
Impairment of Goodwill	135	175	44	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	150	104	1,466	*1,075*	*1,297*
Other Non-Cash Adjustments	413	218	1,461	*-784*	*-900*
(Increase) Decrease in Accounts Receivable	-579	-4,156	-14,071	*-7,238*	*-8,520*
(Increase) Decrease in Inventory	—	—	—	—	—
Change in Other Short-Term Assets	—	—	—	*-2,354*	*-2,842*
Increase (Decrease) in Accounts Payable	1,656	4,517	6,344	*7,762*	*6,953*
Change in Other Short-Term Liabilities	711	2,775	3,234	*7,615*	*9,190*
Cash From Operations	**9,275**	**14,476**	**26,379**	***42,520***	***60,213***
(Capital Expenditures)	-749	-1,046	-3,285	*-5,525*	*-7,203*
Net (Acquisitions), Asset Sales, and Disposals	-1,419	-1,457	-1,491	*-1,715*	*-1,972*
Net Sales (Purchases) of Investments	1,625	-46	-2,747	—	—
Other Investing Cash Flows	418	3,094	-25,474	*-1,050*	*-1,267*
Cash From Investing	**-125**	**545**	**-32,997**	***-8,289***	***-10,442***
Common Stock Issuance (or Repurchase)	616	-12,777	1,638	*50,406*	—
Common Stock (Dividends)	—	—	—	—	—
Short-Term Debt Issuance (or Retirement)	121	1,953	258	—	—
Long-Term Debt Issuance (or Retirement)	—	24,979	5,365	—	—
Other Financing Cash Flows	-262	-15,561	2,103	*-4,442*	*-6,130*
Cash From Financing	**475**	**-1,406**	**9,364**	***45,964***	***-6,130***
Exchange Rates, Discontinued Ops, etc. (net)	-54	-76	-97	—	—
Net Change in Cash	**9,571**	**13,539**	**2,649**	***80,195***	***43,641***

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	0.81	NM	130.3	68.2	29.3	20.3	15.5	44.5	29.2	23.5	15.2	13.6	11.4	1.7	1.4	1.2
eBay Inc EBAY USA	0.83	17.8	16.0	14.3	12.0	10.6	9.4	104.5	15.6	14.0	2.9	2.6	2.3	3.6	3.1	2.8
Average		17.8	73.2	41.3	20.7	15.5	12.5	74.5	22.4	18.8	9.1	8.1	6.9	2.7	2.3	2.0
Alibaba Group Holding Ltd BABA	**1.00**	**—**	**46.8**	**31.1**	**—**	**37.5**	**25.3**	**—**	**36.8**	**25.7**	**—**	**11.4**	**8.3**	**—**	**17.2**	**12.3**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	— USD	0.9	8.0	13.2	2.3	8.0	12.0	1.2	11.0	18.0	0.3	2.3	3.9	—	—	—
eBay Inc EBAY USA	— USD	0.4	14.5	14.2	0.9	21.5	19.8	-0.1	14.2	14.7	0.0	7.5	7.8	—	—	—
Average		0.7	11.3	13.7	1.6	14.8	15.9	0.6	12.6	16.4	0.2	4.9	5.9	—	—	—
Alibaba Group Holding Ltd BABA	**111,549** CNY	**44.7**	**21.3**	**23.6**	**55.5**	**23.3**	**25.2**	**92.8**	**36.8**	**31.2**	**26.6**	**18.4**	**18.5**	**—**	**—**	**—**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	90,747 USD	21.9	18.7	14.1	-55.8	398.7	86.5	-56.9	875.2	91.1	222.6	59.2	24.2	—	—	—
eBay Inc EBAY USA	18,163 USD	13.2	16.1	12.0	10.0	14.1	14.8	9.0	10.6	12.5	-94.9	NM	12.3	—	—	—
Average		17.6	17.4	13.1	-22.9	206.4	50.7	-24.0	442.9	51.8	63.9	59.2	18.3	—	—	—
Alibaba Group Holding Ltd BABA	**52,504** CNY	**52.1**	**50.3**	**40.4**	**73.2**	**34.7**	**46.1**	**179.9**	**17.7**	**50.6**	**-142.1**	**-568.6**	**41.4**	**—**	**—**	**—**

MORNINGSTAR®

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	118 USD	28.9	30.2	31.2	5.5	6.6	7.6	0.4	1.5	2.5	0.1	1.1	1.8	3.7	4.8	5.2
eBay Inc EBAY USA	3,742 USD	68.0	67.6	67.4	29.0	28.2	28.3	20.4	20.1	20.6	20.6	19.6	19.6	3.4	19.8	19.7
Average		48.5	48.9	49.3	17.3	17.4	18.0	10.4	10.8	11.6	10.4	10.4	10.7	3.6	12.3	12.5
Alibaba Group Holding Ltd BABA	**23,315** CNY	**74.5**	**72.0**	**73.0**	**50.7**	**46.0**	**48.6**	**47.6**	**42.6**	**44.3**	**44.4**	**37.2**	**39.9**	**44.0**	**46.9**	**47.8**

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	3,191 USD	32.4	29.0	24.2	24.4	22.5	19.5	29.6	134.9	186.9	0.6	0.4	0.3	4.6	4.8	4.6
eBay Inc EBAY USA	4,962 USD	21.7	16.2	18.1	17.9	14.0	15.3	—	—	—	0.9	0.7	0.8	1.9	1.9	1.9
Average		27.1	22.6	21.2	21.2	18.3	17.4	29.6	134.9	186.9	0.8	0.6	0.6	3.3	3.4	3.3
Alibaba Group Holding Ltd BABA	**41,075** CNY	**103.4**	**34.4**	**25.1**	**50.8**	**25.6**	**20.1**	**12.1**	**14.7**	**21.8**	**1.5**	**1.1**	**0.8**	**2.8**	**1.7**	**1.6**

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Amazon.com Inc AMZN USA	149,931 USD	22.13	28.75	37.70	1.07	1.11	1.17	0.75	0.79	0.86	—	—	—	—	—	—
eBay Inc EBAY USA	65,126 USD	3.66	5.12	8.31	1.67	1.79	1.84	1.67	1.79	1.84	5.45	—	10.50	—	—	—
Average		12.90	16.94	23.01	1.37	1.45	1.51	1.21	1.29	1.35	5.45	—	10.50	—	—	—
Alibaba Group Holding Ltd BABA	**221,579** USD	**18.71**	**49.71**	**67.23**	**1.81**	**2.99**	**3.09**	**1.81**	**2.99**	**3.09**	**4.21**	**11.95**	**16.16**	**—**	**—**	**—**

Research Methodology for Valuing Companies

Components of Our Methodology

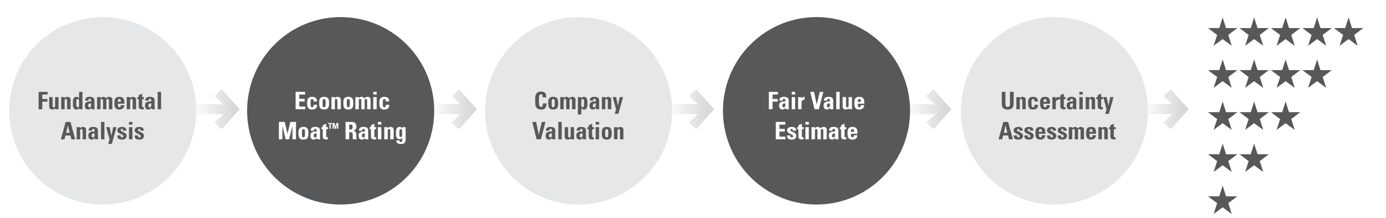
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Analyst conducts company and industry research: ► Financial statement analysis ► Channel checks ► Trade-show visits ► Industry and company reports and journals ► Conference calls ► Management and site visits	Strength of competitive advantage is rated: None, Narrow, or Wide Advantages that confer an economic moat: **High Switching Costs** (Microsoft) **Cost advantage** (Wal-Mart) **Intangible assets** (Johnson & Johnson) **Network Effect** (Mastercard) **Efficient Scale** (Lockheed Martin)	Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows. Assumptions are entered into Morningstar's proprietary discounted cash-flow model.	Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.	The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme. The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.	The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks. The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

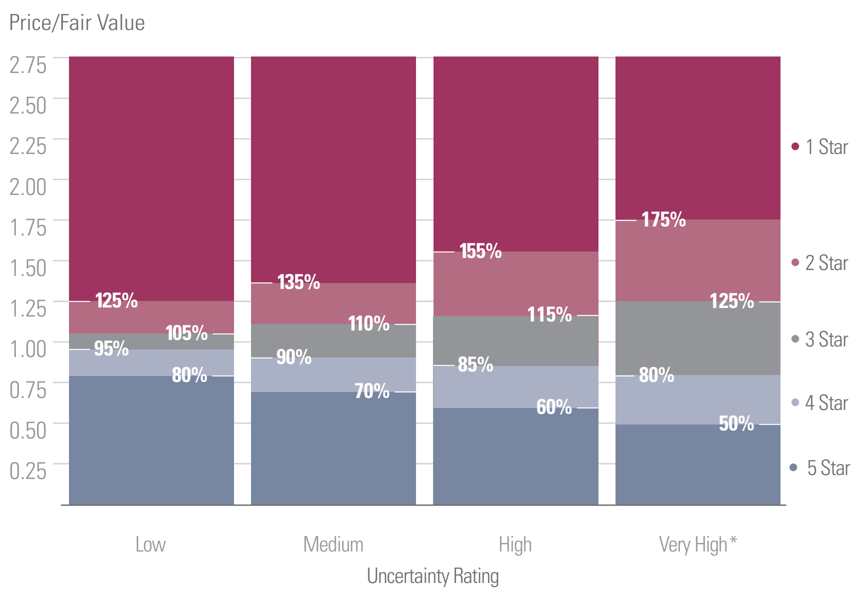
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Morningstar's Approach to Rating Corporate Credit

- Offers a proprietary measure of the credit quality of companies on our coverage list.
- Encapsulates our in-depth modeling and quantitative work in one letter grade.
- Allows investors to rank companies by each of the four underlying components of our credit ratings, including both analyst-driven and quantitative measures.
- Provides access to all the underlying forecasts that go into the rating, available through our institutional service.

Purpose

The Morningstar Corporate Credit Rating measures the ability of a firm to satisfy its debt and debt-like obligations. The higher the rating, the less likely we think the company is to default on these obligations.

The Morningstar Corporate Credit Rating builds on the modeling expertise of our securities research team. For each company, we publish:

- Five years of detailed pro-forma financial statements
- Annual estimates of free cash flow
- Annual forecasts of return on invested capital
- Scenario analyses, including upside and downside cases
- Forecasts of leverage, coverage, and liquidity ratios for five years
- Estimates of off balance sheet liabilities

These forecasts are key inputs into the Morningstar Corporate Credit Rating and are available to subscribers at select.morningstar.com.

Methodology

We feel it's important to perform credit analysis through different lenses—qualitative and quantitative, as well as fundamental and market-driven. We therefore evaluate each company in four broad categories.

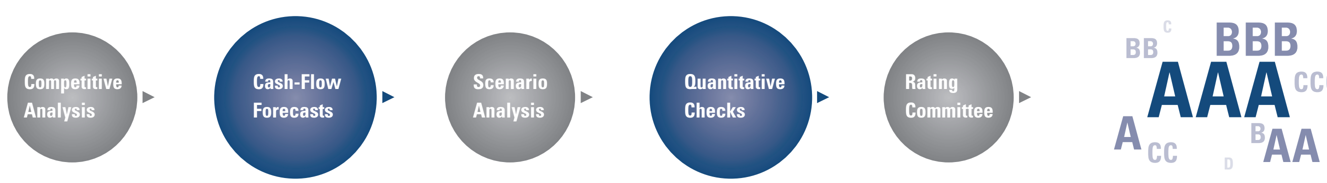
Business Risk

Business Risk captures the fundamental uncertainty around a firm's business operations and the cash flow generated by those operations. Key components of the Business Risk rating include the Morningstar Economic Moat™ Rating and the Morningstar Uncertainty Rating.

Cash Flow Cushion™

Morningstar's proprietary Cash Flow Cushion™ ratio is a fundamental indicator of a firm's future financial health The measure reveals how many times a company's internal cash generation plus total excess liquid cash will cover its debt-like contractual commitments over the next five years. The Cash Flow Cushion acts as a predictor of financial distress, bringing to light potential refinancing, operational, and liquidity risks inherent to the firm.

Morningstar Research Methodology for Determining Corporate Credit Ratings



Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade show visits
- Competitor, supplier, distributor, and customer interviews
- Assign Economic Moat™ Rating

Analyst considers company financial statements and competitive dynamics to forecast future free cash flows to the firm.

Analyst derives estimate of Cash-Flow Cushion™.

Analysts run bull and bear cases through the model to derive alternate estimates of enterprise value.

Based on competitive analysis, cash-flow forecasts, and scenario analysis, the analyst assigns Business Risk.

We gauge a firm's health using quantitative tools supported by our own backtesting and academic research.

- Morningstar Solvency Score™
- Distance to Default

Senior personnel review each company to determine the appropriate final credit rating.

- Review modeling assumptions
- Approve company-specific adjustments

AAA	Extremely Low Default Risk
AA	Very Low Default Risk
A	Low Default Risk
BBB	Moderate Default Risk
BB	Above Average Default Risk
B	High Default Risk
CCC	Currently Very High Default Risk
CC	Currently Extreme Default Risk
C	Imminent Payment Default
D	Payment Default
UR	Under Review
UR+	Positive Credit Implication
UR-	Negative Credit Implication

Morningstar's Approach to Rating Corporate Credit

The advantage of the Cash Flow Cushion ratio relative to other fundamental indicators of credit health is that the measure focuses on the future cash-generating performance of the firm derived from Morningstar's proprietary discounted cash flow model. By making standardized adjustments for certain expenses to reflect their debt-like characteristics, we can compare future projected free cash flows with debt-like cash commitments coming due in any particular year. The forward-looking nature of this metric allows us to anticipate changes in a firm's financial health and pinpoint periods where cash shortfalls are likely to occur.

Morningstar Solvency Score™

The Morningstar Solvency Score™ is a quantitative score derived from both historical and forecasted financial ratios. It includes ratios that focus on liquidity (a company's ability to meet short term cash outflows), profitability (a company's ability to generate profit per unit of input), capital structure (how does the company finance its operations), and interest coverage (how much of profit is used up by interest payments).

Distance to Default

Morningstar's quantitative Distance to Default measure ranks companies on the likelihood that they will tumble into financial distress. The measure is a linear model of the percentile of a firm's leverage (ratio of Enterprise Value to Market Value), the percentile of a firm's equity volatility relative to the rest of the universe and the interaction of these two percentiles. This is a proxy methodology for the common definition of Distance to Default which relies on option-based pricing models. The proxy has the benefit of increased breadth of coverage, greater simplicity of calculation, and more predictive power.

For each of these four categories, we assign a score, which we then translate into a descriptive rating along the scale of Very Good / Good / Fair / Poor / Very Poor.

Overall Credit Rating

The four component ratings roll up into a single preliminary credit rating. To determine the final credit rating, a credit committee of at least five senior research personnel reviews each preliminary rating.

We review credit ratings on a regular basis and as events warrant. Any change in rating must be approved by the Credit Rating Committee.

Investor Access

Morningstar Corporate Credit Ratings are available on Morningstar.com. Our credit research, including detailed cash-flow models that contain all of the components of the Morningstar Corporate Credit Rating, is available to subscribers at select.morningstar.com.

Alibaba Group Holding Ltd BABA (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
89.89 USD	90.00 USD	54.00 USD	139.50 USD	High	Wide	Stable	Poor	—	Retail - Apparel & Specialty

Price/Fair Value Morningstar data as of Sep 22, 2014

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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