



BABA: Strong Team, Arcane Structure

Chairman & Founder Jack Ma (49) famously founded Alibaba in his Lakeside Gardens apartment in Hangzhou, China in 1999. He was Chairman & CEO from 1999 until May 2013, when he transferred the CEO role to his trusted lieutenant, Jonathan Lu (44). It is notable that Ma cites 18 co-founders of the firm, many of whom are still senior managers. Ma continues to serve as Executive Chairman of BABA and steer the firm's strategic course while CEO Lu is the principal operating manager. We like CEO Lu's long track record and think he is well qualified to lead BABA. We see issues with management at BABA but they are more about governance than operating results. This is a seasoned team that we think is likely to deliver on operating goals but that outside shareholders should approach with caution. The arcane capital structure leaves non-Chinese investors as little more than observers. BABA's stock is actually in a Cayman Islands entity that in turn owns a stake in 279 variable interest entities "VIEs" and subsidiaries which are controlled by Jack Ma and co-founder Simon Xie. This is similar to structures at Baidu and Sina Corp. The Board structure leaves the Alibaba Partnership Committee firmly in control and many of the independent directors (including Jerry Yang of Yahoo!) have close ties to Ma. The Board's lack of disclosure on pay and related party issues coincides with management's lack of disclosure on its plans for the net proceeds from the IPO. We think this is indicative of material fiduciary risk for outside investors.



Executive Team Skills Fit We like the seasoned operating experience of this management team. Half of the team has been in place since BABA's founding in 1999. Prior to founding BABA, Jack Ma led two previous e-commerce companies, 1 of which he also founded. He is a strong and talented leader, but his many roles outside of BABA pose a potential conflict for his shareholders. He is a Chairman of The Nature Conservancy's program in China, a Director of The Nature Conservancy, a Director of SoftBank, a Director of Shenzhen-listed Huayi Brothers Media and a co-founder of Yungfeng Capital, a Chinese Private Equity firm. Prior to founding BABA, he worked in Beijing as the General Manager of Cofortune Information Technology Co. (1998 to 1999) and prior to that founded China Pages in 1995, a web designer for Chinese businesses that failed. CEO Jonathan Lu (44) took over from Ma last year and we like his seasoned operating experience in the firm's major divisions. He previously served as Chief Data Officer for about 1 year. Since becoming CEO in May 2013, he has grown revenue by 67%. CEO Lu joined BABA in 2000 after Jack Ma acquired the network communications company Lu founded. He then led BABA sales in Southern China until 2004. He served with the Alipay affiliate until 2008, last serving as President. In 2008, Ma assigned him to the Taobao unit (BABA's online marketplace for Chinese residents), and promoted him to lead the unit as CEO in 2010. In 2011, he was promoted to CEO of Alibaba.com, which was briefly listed in Hong Kong. Maggie Wu (46) replaced Joe Tsai as the CFO in 2013. We think her strong track record and IPO experience will be a key element to BABA's transition to a U.S.-listed company. While revenue has increased about 67% during her tenure, she improved operating and operating cash flow margins by 990 bps and 1.2k bps, respectively. CFO Wu joined in 2007 as the CFO of Alibaba.com to lead its \$1.5 billion IPO. She then served as BABA's Deputy CFO from 2011 until her promotion to full CFO. Wu was previously the Lead Audit Partner for KPMG in Beijing, where she worked for 15 years. Of the senior executive team, five are also members of the Partnership Committee ("PC"), the group in charge of the Alibaba Partnership. Jack Ma runs the Partnership Committee which, through the Articles of Association (functionally bylaws) controls the majority of Board seats. Joe Tsai (50) became Executive Vice Chairman in May 2013, after serving as BABA's CFO since 1999. He is well-qualified for the role. Prior to meeting Ma in 1999, he led Private Equity investments in Asia for the Wallenberg family's Investor AB for about 5 years. Tsai utilized that experience to steer BABA's incorporation and raise investment capital from leading international entities including: Goldman Sachs (\$3 million in 1999), SoftBank (\$20 million in 2000), Yahoo! (\$1 billion in 2005) and Silver Lake and DST Global (about \$1.6 billion in 2011). SVP

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Corporate Strategy Ming Zeng (44) has held lead strategy roles since joining in 2006. Zeng briefly served as EVP, Strategy before being promoted to President of China Yahoo and then to Chief Strategy Officer of BABA in 2008. Lucy Peng (40) is the CEO of Small & Micro Financial Services (Alipay's parent company, controlled by Jack Ma), and was reappointed as BABA's Chief People Officer, in June. She has been responsible for Alipay since 2010 and served as CPO during most of her tenure from 1999 until 2010. We note that Executive Vice Chairman Tsai and CFO Wu are based in Hong Kong, about 600 miles from BABA's HQ in Hangzhou. The Partnership Committee members are: Exec Chair Ma, Exec Vice Chair Tsai, CEO Lu, SVP Zeng and SMFS head Peng.

Compensation & Alignment Analysis We think management's cash compensation is reasonable at 1.39% (about \$56 million) of reported EBIT. This is especially true since that amount covers both salaries and annual cash bonuses for all of the Officers & Directors of BABA. Compensation disclosure is limited, however, in the filing documentation available. Cash compensation is only disclosed in aggregate, while equity grants to senior management are disclosed for only Chairman Ma and Vice Chairman Tsai, the two employees who beneficially own at least 1% of BABA. Both received restricted stock units ("RSUs"), while other executives received a mix of options and RSUs that vest ratably over 4 years. The allocation of annual cash bonuses among management is determined by the five members of the PC committee. BABA is on a March fiscal year and for FY '13, Ma and Tsai received reasonable RSU grants worth \$7.1 million and \$3.5 million, respectively. We don't like that management's RSUs are time based and comprised 75% of total long term incentives for managers with options representing the balance. Information on performance metrics or target awards is not currently provided. The Board says it has a long term incentive plan, but does not disclose performance metrics or vesting schedules.

Equity Ownership Analysis Except for Jack Ma and Joe Tsai (who own about 12.4% combined), BABA does not disclose the beneficial equity ownership of individual Officers & Directors. It also does not disclose which investors might sell in the IPO. Yahoo! owns 22.4% and SoftBank owns 34.1%. We note that Yahoo is obligated to sell 140 million shares (26% of its beneficial stake or about 6% of BABA) in the IPO. Yahoo (post its initial sale) and SoftBank are contractually obligated to hold their stakes for at least a year. Executive Chairman Ma is the largest beneficial owner at 206 million shares (8.8%), and Executive Vice Chairman Tsai owns 83 million shares (3.6%). Equity options granted to senior management in 2013 have a strike price of \$18.50. Assuming that the strike price of recently granted options is about \$59, the value of management's options are just over 200% in-the-money, providing strong alignment. Insiders have a standard six month lock-up on their post-IPO shares.

Capital Allocation Practices Management's capital allocation has consistently focused on acquisitions and R&D investments. Management says it will not pay dividends post-IPO. We think it is notable that management does not clearly articulate its plans for the net proceeds from the IPO. Earlier this month, Alibaba Pictures (formerly ChinaVision) announced that it would postpone the release of H1 earnings due to potential accounting issues relating to its accounting for assets. BABA has spent about \$2.6 billion on acquisitions just since March of this year, including a 60% stake in ChinaVision in June for about \$805 million. R&D has been a material use of cash, growing 5.3x since 2010 (10.5% of revenue).

Other Fiduciary Issues There are numerous fiduciary issues with the Board of BABA, most important being the post-IPO Board structure. The Alibaba Partnership will control a simple majority of seats. Insiders: Jack Ma, Joe Tsai, SoftBank, and Yahoo are partners to a voting agreement, by which they will vote for each other's director nominees. Yahoo and SoftBank will each have 1 seat. Assuming that only Yahoo sells in the initial IPO, these entities will control about 51% of BABA. Also, 2 of the 4 independent directors have close ties to Jack Ma. Walter Kwauk (61) was a Director of Alibaba.com and J. Michael Evans (56) was Vice Chair of Goldman Sachs (Goldman and other firms lent \$8 billion to BABA in 2013).

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