Equity Report [1/5/2021]

JD.com Inc.

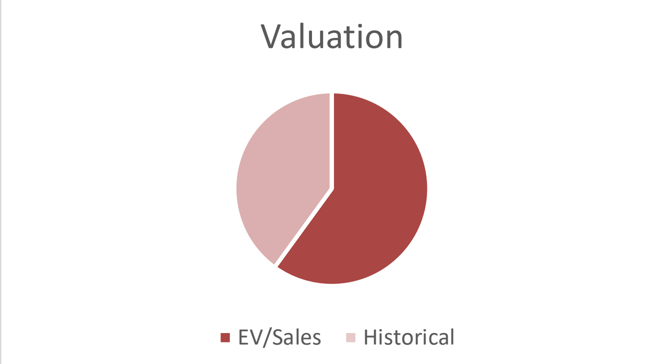
Internet and Direct Marketing Retail

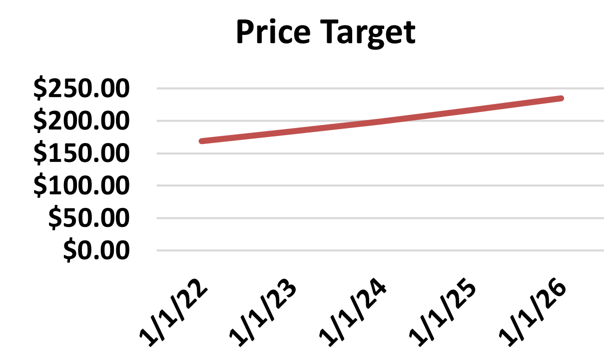
NASDAQ Symbol: JD

Recommendation: BUY

Covering Analyst: John Davis

Intrinsic Value:

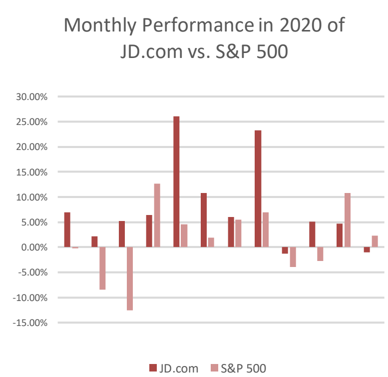




Capital Structure	
Equity	99.50%
Debt	0.50%
CAPM Presumptions	
Beta	0.93
Risk Premium	6.00%
Risk-Free Rate	3.80%
Terminal Growth Rate	5.00%
WACC Presumptions	
Cost of Equity	9.4%
Cost of Debt	4.1%
Cost of Capital	9.4%

Intrinsic Value	Margin of safety
$140.63	**53.6%**

Source: Company Data, Group Estimates



Executive Summary

This equity report provides an analysis and evaluation of the current and future performance of **JD.com Inc.** over a future period of five years. My methods of analysis include the **discounted cash flows model (DCF) and relative (comparative) model,** as well as various ratios including but not limited to ROA, ROE, ROIC, liquidity ratios, capital structure ratios, and profitability ratios.

Results of data analyzed show that the company is fundamentally sound. Overall, the company is continuing to shrink their operating margin to drive higher profit. The company maintains a healthy balance sheet with strong cash positions.

My report finds that the prospects of the company in its current position are **very positive**. The primary catalysts for long-term growth include:

- Strong partnerships with several global corporations
- Continued rapid economic growth in China which are projected to outpace the growth of the United States' economy
- Investment into new and potentially very profitable businesses

I conclude that this company's stock is **extremely undervalued**, resulting in a margin of safety of **53.6%**. Reasons that the market has placed this stock at value include:

- 2019 was the first fiscal year in which JD.com posted a positive operating margin
- Manage their own logistics and shipping for their retail business which has been extremely capital intensive to build
- Continued tension between the United States and China, with a threat of potentially being taken off of the NASDAQ
- Historically JD.com's key competitor, Alibaba, has had a strong market share on e-commerce in China with a much more lightweigh business model and JD.com has been overlooked

Key Stock Statistics:

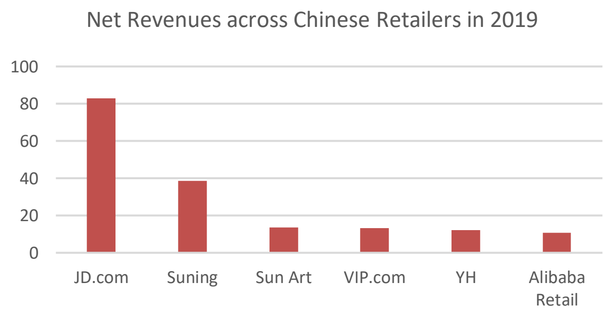
52-Wk Range ($)	32.70-96.20	Dividend Yield	0.00%	Book Value/Share (mrq)	6.72
Beta	0.91	Diluted EPS (ttm)	2.73	Operating Margin (ttm)	1.60%
Market Capitalization ($BN)	133.80	P/E (ttm)	32.33	S&P Credit Rating	N/A
Forward Annual Dividend	0.00%	P/B (mrq)	5.81	Institutional Ownership	47.66%

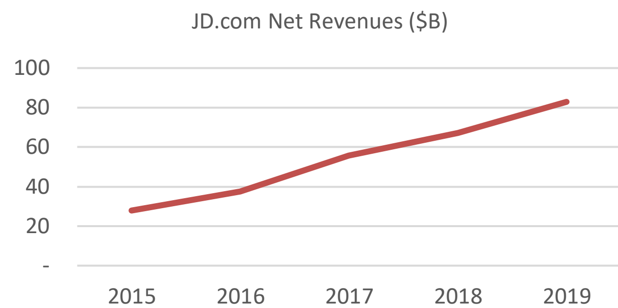
Source: Fidelity

Business Description

Headquartered in Beijing, JD.com is one of China's largest retailers and online marketplaces. Not only do they provide a seamless place to shop from their selection of sourced goods, but also other vendor's goods. Backed by their own logistics division, JD.com processes and ships all of the goods sold on their platform. They aim to be a global leader in supply chain and logistics technologies and services. In 2019 the company amassed over $80B in revenue from their array of products and services. With continued investment and development into new divisions, the company aspires to provide everyone with the ability to provide consumers with "whatever they want, whenever and wherever they want it".

Revenue Drivers

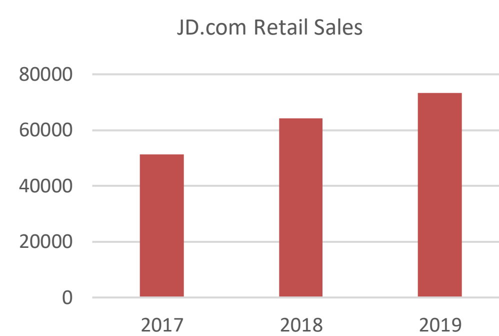




As of their latest earnings reports, only the JD Retail business unit has been profitable. Within the JD retail business unit, there are four distinct segments: online retail, online marketplace, omni-channel initiatives, and marketing services. Overall, the company has seen significant revenue growth with a CAGR of 31% since 2016. JD.com also holds a large market share in the Chinese retail market with more than double the net revenues of the next largest retailer.

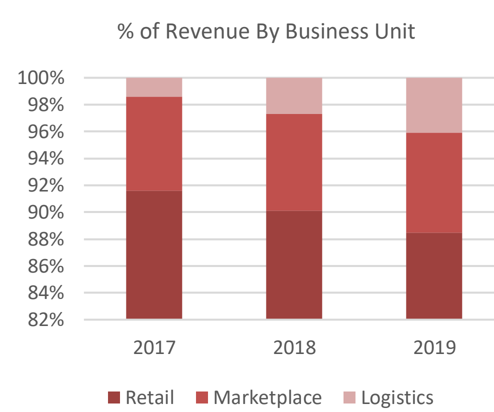
Online Retail

Online retail is the largest and most profitable part of JD.com's business. This business consists of sourcing products from different manufacturers then marketing, selling, and shipping these products across China. With the help of their subsidiary JD Logistics, they are able to manage the supply chain once they acquire the goods from the manufacturer. As of the end of 2019, the company had agreements to source products from over 24,000 manufacturers. The company maintains very strong relationships with all of the manufacturers. As JD.com continues to gain scale from expansion, they believe these relationships will foster lower cost of goods which will continue to drive operating margins up.

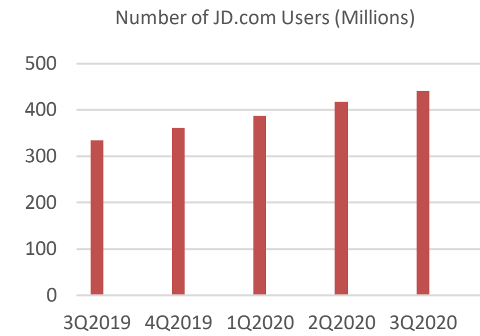


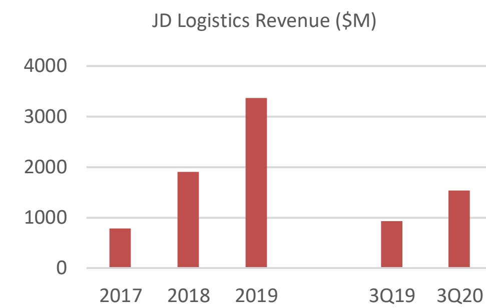
Online Marketplace and Marketing

The second most profitable business unit is JD.com's marketplace and marketing services unit. This unit was created to directly compete with Alibaba. Alibaba is primarily an online marketplace; they do not own any of the products and do not manage any of their own logistics which makes their business model much more lightweight. JD.com improves upon the general online marketplace idea by supporting the service with their logistics business. All manufacturers who use JD's platform have all of their logistics (shipping, handling, etc.) managed by JD. This comparative advantage was highlighted during the COVID-19 pandemic when Alibaba struggled to get packages delivered to their customers since the companies they relied on for shipping and logistics could not maintain the influx of business they were receiving. On the other hand, JD.com had no problems



fulfilling their marketplace orders. Currently, the e-commerce B2C (business to consumer, i.e., marketplace) market is dominated by Alibaba, however, their market share is continuing to decrease as JD.com continues to increase their share. As of 2020, JD.com maintains a 26.5% share of sales in the online marketplace market. This area of the business is also ripe for new growth as JD.com forms strategic partnerships with luxury brands across the world. Brands like Salvatore Ferragamo are beginning to use JD.com's platform to provide the supply of goods that are demanded by Chinese consumers. The other aspect of their business is their marketing platform that they provide as a service to manufacturers that use their marketplace. They employ intelligent software marketing and advertising services that harness the large amounts of data accessible to company about Chinese online shoppers.





Logistics Business

JD Logistics, one of the company's subsidiaries, is the core of the company's strategic plan moving forward. JD Logistics owns and operates all of the warehouses, transportation mediums, and fulfillment centers for the retail and warehouse business. Currently the company owns front-line warehouses in 31 cities and over 800 different warehouses with coverage over nearly all counties and cities in mainland China. This extensive network of coverage for their logisitics rivals that of major logisitics companies in the country and is the largest of its kind amongst other e-commerce companies. Much of the reason for the debt burden and low operating margins this company saw previously can be contributed to the significant investment to build the logisitics department. Currently, the company is beginning to offer the services of their network to customers outside of their retail and marketplace platform. Moving forward this is going to be one of the key revenue drivers for the company. With their reach into more rural areas in China, they are poised for continued growth as the rest of China moves into the 21st century.

New Business Ventures and Investments

In addition to their core business, JD.com also has begun building out their future with several larger undertakings to have better horizontal integration. They do this by further creating subsidiaries as well as contribute capital to receive a minority stake in several external ventures.

JD Health

JD Health is the company's venture into the healthcare space. Their goal is to combine the internet with modern healthcare. In 2019 JD.com sold approximately 13% of the company to raise a round of funding of more than $900M. In 2020, the company had its' IPO on the Hong Kong Exchange to gain further capital to expand their business. The IPO provided them with over $3B in additional funding for R&D and business expansion. After the IPO, JD.com still retains a majority stake in the company. In the first six months of 2020, JD Health had brought in a revenue of $1.5B. Their main offerings include 24/7 virtual doctor's visits and prescription delivery.

JD Digits

JD Digits is a software service former subsidiary of the company. Awaiting a potential IPO, JD Digits was built to compete with the financial technology offering from Alibaba, the Ant Group. The company offers enterprise software primarily pertinent to the financial industry. JD Digits has been one of the larger failures of the parent company. Only generating yearly revenues of around $100M, the company has been largely overshadowed by their direct competitor Ant. Looming government restrictions and problems in the space has caused the IPO to be pushed to a later date. Currently, JD.com has removed JD Digits as a subsidiary and instead have turned their position into a stakeholder with the option to exercise their equity in the event that the company becomes profitable.

External Investments

JD.com also owns large stakes in several other ventures which are listed below with their corresponding ownership stake:

Yonghui	12%
Bitauto	25%
Tuniu	7%
Jiangsu Five Star	46%
Dada	41%

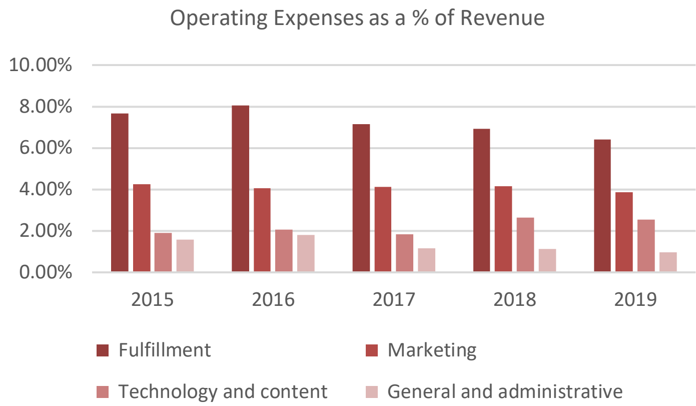
All of these represent various important aspects of current or future businesses. Yonghui is a large chain of superstores in China. This ownership stake is part of a greater partnership to improve online-to-offline sales. This essentially just is an order online and pickup in store aspect that is common in the United States. Bitauto (which has seen been merged into another large Chinese software company) provided software for the automotive industry. Tuniu is a travel and leisure company specializing in online travel planning. The two most important of the investments are Jiangsu Five Star and Dada. Jiangsu Five Star is a home appliance manufacturer. As home appliances represent over 57% of the total revenues for JD.com it is vital they possess this strategic ownership stake to ensure the lowest possible prices and a consistent inventory for their largest slate of product offerings. The second investment is in the food and grocery delivery company Dada. Since the 2019 FY report, JD.com has gained a majority ownership stake in the company which provides its' customers with rapid same-day delivery for local retailers. The ownership in Dada is vital to their omni-channel goal to provide their customers with whatever they want whenever they want it. In aggregate these investments have generated an average YOY growth of 25% over the past three years.

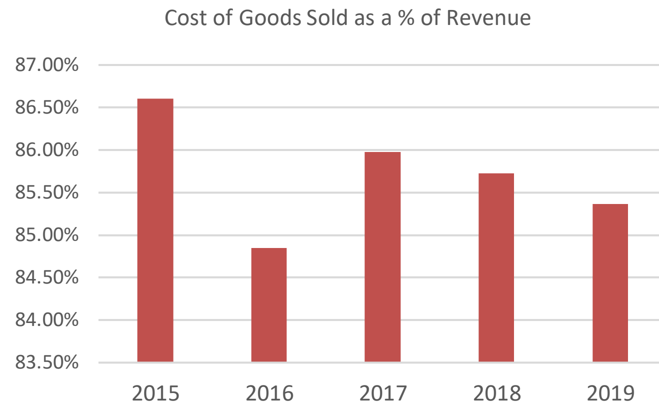
Strategic Partnerships

JD.com has developed several strategic partnerships with several Chinese and global corporations. Tencent, the largest internet and communication company in China, owns a platform called WeChat which is the primary form of communication for many Chinese people with an active user amount of over 1.1 billion people. The partnership with Tencent aims to shrink the footprint of their shared rival Alibaba. The agreement provides direct integration between JD.com's platform and WeChat. This greatly increases the traffic to JD's platform and benefits shared customers between the two platforms. In addition to the platform integration, Tencent also agreed to a non-compete in the e-commerce space for eight years. JD.com also acquired Tencent's existing marketplace platforms. In exchange, Tencent received significant stake (minority) in the company. Another partnership they formed was with the American software company Google. Google's partnership with JD is currently in its' infancy. Google made a $500 million investment in JD in exchange for supply chain and logistics expertise in their new Google Shopping endeavor. The final significant partnership was made with American retailer Walmart. This partnership gave ownership of Walmart's online grocery business, Yihaodian, to JD.com. Additionally, Walmart harnessed the supply chain and logistics infrastructure of JD Logistics to support their retail business in China. Walmart also invested in the company to receive a stake in JD.com.

Cost Drivers

Traditional retail businesses typically have very small operating margins. This is due to a very high cost for goods sold. Since retailers have to purchase the goods from the manufacturers, they only profit on the small upcharge from selling the good. This is no different for online retailers such as JD.com. In addition to cost of goods sold, there are several other operating expenses that come from running the business itself.





Cost of Goods Sold

As mentioned above, the primary cost of goods sold is from the purchase of merchandise from suppliers. Additionally, the cost of shipping is included within this cost. Since shipping is handled by JD Logistics, a subsidiary, part of this cost is actually recognized as revenue on another line item. Moving forward, this number will continue to be driven down by the increase in transactions from their marketplace as well as further discounted prices from manufacturers as the number of traffic to the platform increases.

Fulfillment

Fulfillment expenses are caused by the operating leases, expenses from inventories, inspections, amongst other costs. These are expected to maintain the same percent of revenue moving forward as the company continues to increase their footprint across China.

Marketing

Marketing expenses are caused by advertising and other marketing expenses to drive traffic to platform. While these costs will continue to increase, they are expected to shrink as a percentage of revenue moving forward.

Technology and Content

Technology and content, which has been renamed research and development, consists of all costs related to the development of new software offerings. As JD.com wants to continue to expand their digital footprint, this value will continue to increase proportional to revenue. In other words, this will maintain the same percentage of revenue, if not increase, in the next five years.

General and Administrative

This operating expense deals with all other costs relating to the business. This is already a small part of operating expense that has been trending smaller as a percentage of revenue. Expect this same trend to be seen moving forward.

Industry Overview

Industry Growth

The global e-commerce is valued at over $3T in 2020. This number is set to nearly double in the next 4 years. Currently, it makes up less than 20% of the total retail market, however, it will continue to grow in proportion to the total retail market moving forward. As of 2020, JD.com owned 9% of the entire e-commerce market, which is third to Amazon and Alibaba. JD only operates within the confines of China at present however, they are in the very early planning stage to enter several other global markets, most specifically within other APAC markets. The Chinese e-commerce market is valued at over $1.1T as of 2020 compared to the value of the Chinese retail market of $6.5T. Since 2012, the online e-commerce space has nearly tripled their market penetration into the traditional retail space. The space of e-commerce in China has experienced a CAGR of 32% from 2012-2020. Moving forward, the market is expected to slow down growth to possess a CAGR of 10% over the next 4 years. There is already significant market penetration into the more developed parts of the country (Beijing, Shanghai, etc.) so most of this growth is focused on less developed parts of mainland China. JD.com is well positioned to grow faster than the market due to their comparative advantage of well-developed logistics in these high growth areas.

Industry Disruptors

JD.com and other e-commerce players are members of the disruptor class within the retail industry. As discussed above, online retail and marketplace platforms are gaining large penetration into the traditional retail space which had previously been dominated by traditional brick-and-mortar stores. However, one popular form of online e-commerce is beginning to disrupt the full online experience. With most fully online experience, consumers don't get the instant gratification of owning the goods they purchase right away (typically they have to wait for shipping). Enter the online to offline commerce business. This form of commerce provides the online experience with the instant delivery of goods. An example of this is Instacart. Order your groceries online and have them delivered to your door within the hour. The same can be done for appliances, fast food, and all other goods. JD.com is also committing heavy investment into this form of commerce and is well positioned to gain from its emergence.

Key Competitors

At present, there are two main players in the Chinese e-commerce battle: Alibaba and JD.com. While they are different in their business plans, they are competing for the share within the same market. Alibaba started it out as a marketplace, but is now attempting to move in the retailing business. The opposite can be said for JD.com, however, JD is doing a much better job of pivoting than Alibaba is according to their market shares each other's original domain. In terms of positioning for the future, JD.com is in a much better place to grow and ride the wave of China's economic transition. During the COVID-19 pandemic, the lack of Alibaba's own logistic business limited their ability to keep up with their influx of business. Many packages were late, and customers were unhappy. These problems weren't experienced by JD.com customers who were much better serviced during the pandemic. As growth shifts away from large Chinese cities and moves east where cities aren't as developed, Alibaba's lack of a logistics division will only be exacerbated. Additionally, the Chinese government's relationship with Alibaba has struggled recently, especially with the failed IPO of Alibaba's ANT Group.

Competitive Analysis

I analyzed JD.com's competitive positioning by constructing a SWOT analysis and a Porters' Five Forces model. These allowed me to evaluate the company's potential for future growth.

SWOT Analysis

Strengths

- Global partnerships with several companies including Tencent, Google, and Walmart
- Strong relationships with countless manufacturers
- Extensive infrastructure for order fulfillment

Weaknesses

- Small, and only recently positive, operating margins
- Revenue generating footprint is limited to China alone

Opportunities

- Several emerging markets in APAC (Vietnam, Laos, etc.)

- Omni-channel endeavors such as same-day grocery delivery
- High growth areas of China without the same development as the major cities
- Additional software services such as healthcare

Threats

- Competitive industry without large barriers to entry (only the marketplace business)
- Global players, such as Amazon, seeking to gain market share within Chinese markets
- The Chinese government

Porter's Five Forces

Porter's five forces, which provide a framework for industry analysis, were formulated by Michael E. Porter of Harvard Business School in 1979. Following are the five parameters on which I analyzed JD.com Inc., and their position within the internet and direct marketing retail industry.

Rivalry Amongst Sellers | High

In the retail and marketplace industry there is a very high level of competition. It is very hard to distinguish a service from one another as the customer can find the same product on several different platforms.

Threat of Substitutes | Low

The threat of substitutes is high. A buyer can choose to not shop in a certain company's stores or on their platform and feel nearly no loss. Manufacturers provide their goods on more than one platform for the most part, which means a consumer can very easily change the medium on which they purchase the good.

Pressure from Supplier Bargaining Power | Medium-High

Good suppliers have a large amount of power. For goods that are in high demand from consumers, retailers are forced to pay the price in order for the goods to show up in their stores or on their platforms. However, larger retailers have some leverage in negotiations since manufacturers need to be exposed to a large number of customers which is only possible through a few major platforms.

Threat of New Entrants | Medium

Overall, the threat of new entrants is high. There is not a large amount of capital investment mandatory for building an e-commerce platform. However, developing the strategic relationships with manufacturers and building the right supply chain takes a long time.

Pressure from Buyer Bargaining Power | Low

Buyer power is low. While there are a lot of options out there to choose from, an individual buyer does not have much leverage at all. This is because a single consumer's transactions don't greatly affect the bottom line of a retailer.

Financial Analysis

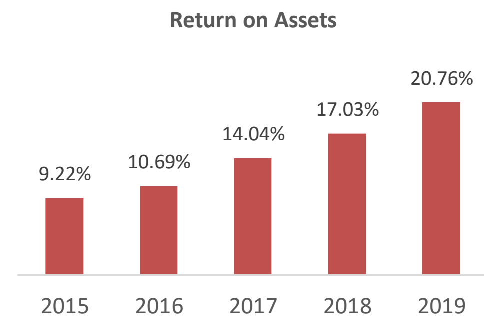
My financial analysis involves the use of a DuPont method and other financial ratios. These are especially useful in evaluating a company's ability to deploy, retain, and generate income. JD.com has promising fundamentals that lend the company capacity to expand safely to maintain a competitive advantage in the machine vision industry.

DuPont Analysis

A DuPont analysis involves breaking down ROA, ROE, and ROIC into granular components for detailed analysis. As JD.com is not a financial institution, note that ROE is less relevant than ROIC and ROA in analyzing company performance.

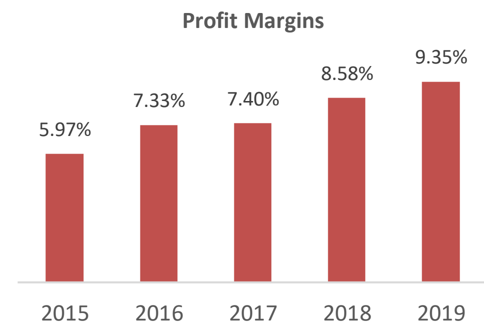
Return on Assets (ROA)

Return on assets is calculated using the DuPont method, breaking down the calculation into two separate ratios. Profit margin and asset turnover are calculated, and the product is ROA. Overall, JD.com has continued to improve over the past five years. The company increased its ROA by 3.73% for a FY 2020 ROA of 20.76%. The company has maintained a steady growth of ROA in the past. Moving forward, a similar trend is expected as they continue to reap the benefits of hitting scale. In absolute terms, an ROA of 20% is high which suggests an efficient generation of earnings.



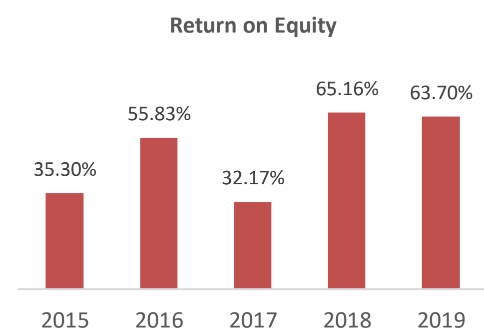
- Profit Margin

  Profit margin is calculated as net income divided by total revenues. This indicates the percent of cash remaining after incurring all expenses. Much like their ROA, JD.com maintains a strong and steady profit margin growth. For retail businesses, a profit margin is typically lower due to the high costs, however, JD's profit margins are healthy for a business in this industry. Expect this value to continue to decrease as they grow larger. Retailers at scale tend to have much better margins than smaller ones. Another aspect that may increase this value in the long term is that they are moving towards different businesses which historically have higher profit margins.



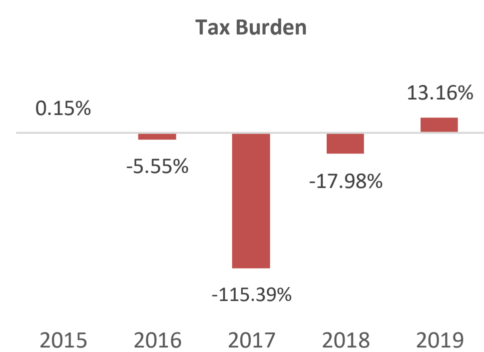
Return on Equity (ROE)

Return on equity (ROE) is calculated utilizing the DuPont method, breaking down the calculation into five separate ratios: tax burden, interest burden, operating margin, asset turnover, and leverage ratio—the product of these ratios results in ROE. JD.com had an ROE in FY 2020 63.7%. In the retail industry, ROE is not necessarily a reliable indicator of the company's ability to provide future returns. However, the high ROE values are a sign that JD.com effectively manages their assets. The company's continued increase in ROE is a sign of strong underlying fundamentals.

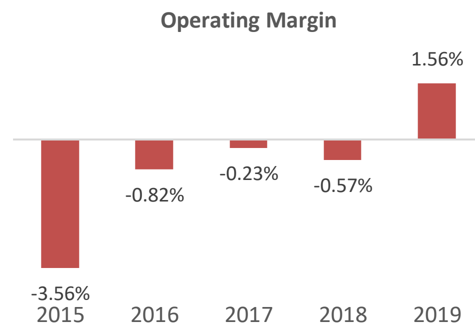


- Tax Burden

  The tax burden is calculated as net income divided by earnings before tax (EBIT). This is an indication of money lost due to tax. In the case of JD.com, the tax burden has been historically negative due to only recently hitting profitability. In the past five years JD.com has actually received tax benefits (income), and it only recently paying taxes due to its' positive net income. Moving forward look for this value to increase to 15-25% which is the standard corporate tax rate in China.

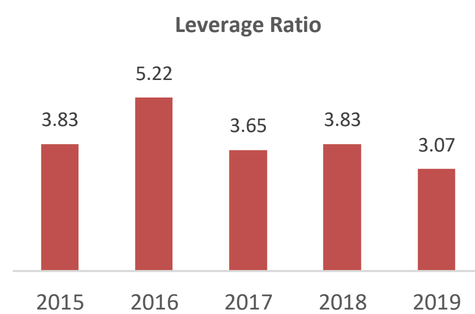


- Operating Profit Margin



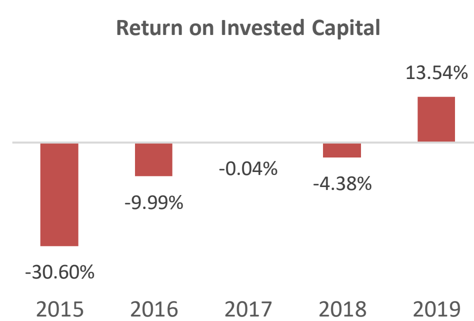
Operating profit margin is calculated by dividing earnings before interest and tax (EBIT) also called operating profit by total revenues. Operating profit margin is used to analyze what percentage of total revenues remains after both cost of goods sold and operating expenses such as RD&E and SG&A are deducted from total revenues. This is a very common first indicator of a company's financial health. It allows investors to determine if the company is experiencing operational inefficiencies. Common causes of reductions in operating margin include M&A activities, which can inflict administrative cost if the merger is non-coherent, and unexpected litigation. JD.com has experienced a steady increase in OPM. This is because they are beginning to hit scale and the very cost-intensive logistics division is beginning to turn profit. Additionally, as JD.com gains new users to their platform, they can better negotiate with suppliers on the cost of the goods sold. This will drive down COGS. Additionally, they are increasing revenues without proportionally increasing their operating expenses which is a strong sign of efficiency.

- Leverage Ratio



The leverage ratio is calculated by dividing total assets by shareholders' equity. This allows investors to interpret the proportion of assets per share dollar of equity raised by the company. A leverage ratio above one indicates that the company is not leveraged, this improves overall ROE. JD.com's leverage ratio has maintained relatively stagnant at around three times. Between the high ratio and the stagnant trend, this shows that the company has a strong financial position, and the value of equity is backed by more than three times the value of assets of the company.

Return on Invested Capital (ROIC)



Return on invested capital (ROIC) is calculated utilizing the DuPont method, breaking down the calculation into two separate ratios: NOPAT to total revenues and total revenues to invested capital. The product of these two ratios produces ROIC. ROIC is of particular importance in determining a manufacturing company's health and ability to use invested capital to generate future cash flows wisely. JD.com has demonstrated steady growth in ROIC since its low in FY 2015. Apple has provided three out of four years of increasing ROIC. From FY 2018 to FY 2020, JD.com greatly increased their ROIC from -4.38% to 13.54%. This trend can be attributed to finally hitting profitability. The strong and steady ROIC growth suggests that JD.com will continue to develop stronger and stronger cash flow as their business begins to mature.

Valuation

My valuation is the result of a combination of two methods. These methods offer value-added exposure to multiple levels of analysis. These models include a discounted cash flow model and relative (comparable) model. To come to a final intrinsic value, each model was given a weighting based on my analysis of each methods applicability to JD.com's past, present, and future.

Discounted Cash Flow (DCF)

I employed a discounted cash flows analysis as one of my methods to derive a price target for JD.com. In my model, I forecasted future free cash flows through the FY 2024E. This time horizon appropriately captures several expected growth trends in JD's operating results while maintaining a reasonable level of predictability. In my final valuation, I gave this model a 60% weighting because it reflects the highest level of detail out of any other model used in my valuation process.

Revenue

Revenue was projected using a compound annualized percentage growth rate. I selected this method over using a year-over-year growth rate because JD.com does not break down revenues on a product line basis. My revenue growth projections took into consideration historical growth rates, projected market growth, and a qualitive assessment of JD's business strategy and position.

Cost of Goods Sold (COGS)

I projected COGS as a percentage of revenue, in line with management guidance regarding sustaining gross margins in the mid 80% range. As they continue to increase their footprint and develop their logistics division, this figure will shrink slightly which is represented in the projections.

Depreciation and Amortization

Expect D&A to maintain its current proportion to revenue. As JD.com continues to expand, they will increase their capital expenditures to continue to grow the logistics business. This will contribute to the same level of D&A as they have had in the past. It is projected according to its historic growth.

Operating Expenses

Operating expenses were projected as a percentage of revenue. JD.com has four operating expense segments: fulfillment, market, technology and content (R&D), and general and administrative. Based on management guidance I have projected these out as either decreasing, increasing, or stagnant.

Net Working Capital

Total current assets and liabilities were projected using management guidance and historical growth rates. As they reach profitability and scale they will continue their attempts to expand their business. This will lead to an increase in assets. Historically, the company had to incur large amounts of liabilities in their effort to expand their logistics business. The amount of liabilities on their balance sheet will continue to decrease as they invest more of the company's profit into the growth as opposed to external investors.

Capital Expenditures

Capital expenditures were projected as a percentage of revenue. Their CAPEX includes payments for acquisition of property, plant, and equipment. Historically, JD.com has low levels of capital expenditures relative to revenue (around 1.1%), as the majority of investment is through the T&C line item. I projected this to be a constant percentage of 1.1%.

Beta

Beta was estimated by using the bottom-up beta method. After performing market beta regression over JD, I did not feel as though there was a high enough regression correlation to be considered accurate for the model. Instead, I calculated the bottom-up beta using the comparable companies found within the relative model. For this calculation, I found a beta of 0.93 which I feel better represents the true nature of the company.

Terminal Value Calculations

I calculated the terminal value based on two different methods, the Perpetual Growth Method (PGM) and the Exit Multiple Method (EMM). For the PGM, a terminal growth rate of 5% was used to reflect JD's growth trend into perpetuity following the terminal year. While 5% is China's projected economic growth for the future, this did not adequately reflect the growth potential of the company. Therefore, I used the EMM method to calculate the terminal value. To do this, I used JD.com's current EV/Sales multiple of 2.7% and applied it to the terminal projected revenue of $218.3 billion. Using this approach, I calculated the final EV as approximately $422.5B. This value corresponds to a 6.4% terminal growth rate, which I feel is appropriate given JD.com's growth prospects within China.

Capital Asset Pricing Model (CAPM) & Weighted Average Cost of Capital (WACC) Presumptions

In calculating JD.com's cost of equity, I used the capital asset pricing model (CAPM). I used the OSIG standard equity risk premium of 6.0%, along with risk-free rate data from the 30-year Chinese Bond; resulting in an 9.4% cost of equity. Even though JD.com currently carries long-term debt, the calculated weighted average cost of capital (WACC) returned a value of 9.4%.

Comparable Model

The publicly-traded comparable analysis was also used as a method of valuing JD.com. JD.com's main competitor in their industry is Alibaba, who is weighted in the model. However, the company with the highest weighting in the model is Amazon due to the similarities between the two business models. Amazon aims to own the supply chain and deliver their own logistics which is very similar to JD's goal. This is unlike Alibaba, which is why I believe Amazon's ratios to most accurately depict the valuation of JD. Other companies I included were Walmart (to have influence from a retailer), Tencent (due to region and market cap), Baozun (same industry, Chinese e-commerce), as well as XPO Logistics and FedEx (American supply chain and logistics companies). As a group, this represents the market, business strategy, and future endeavors of the business. Taking into account the weights of each multiple, I arrived at an implied price of $135.13 per share, which I believe accurately accounts for JD.com's potential upside in the near term. Therefore, I gave the comparable model a 40% overall weighting in my final valuation. This weighting reflects my general preference for intrinsic valuation.

Multiples

P/S – 50%

JD.com is less profitable than its competitors since it is still a much younger company which is why the P/S ratio had much less variability across the board. It is important to use this metric because it weights the value of JD based on the volume of sales they have.

EV/Sales – 50%

EV/Sales is the standard for companies that are newly profitable and less mature. For retailers and online marketplaces, it is important to drive sales through a platform, thus sales are the most important metric to weight in this scenario.

Catalysts for Long-Term Growth

In my research, I have identified several catalysts for long-term **growth:**

- The development of key strategic partnerships with large global brands such as Tencent, Google, and Walmart
- Strong strategic positions in higher growth parts of China. Additionally, doing business in China provides higher growth opportunities as it has higher projected growth as an economy
- Large and successful development of additional business units such as JD Logistics and JD Health

Risks to Projections and Expectations

The primary risk to the projections and analysis of JD.com is the unpredictability of the Chinese government. In the business of logistics, a good relationship with the government is crucial to getting around the "red tape". However, the Chinese government has had relationships with several corporations or CEOs soured. The companies in question then could see repercussions in the form of regulation could seriously affect the company's bottom line. Additionally, they could unilaterally pass tax laws to increase taxes on a certain company. Maintaining a good relationship with the government is absolutely vital for the projections to be accurate. Another risk to these projections is for global companies, such as Amazon, to take additional market share available. Slowed economic growth in China could also severally impact the accuracy of my projections. The current projections assume a rather high level of economic growth for China, mostly in regions of Eastern China that are much less developed. These areas failing to grow at a fast rate, or JD.com not being able to build on their existing advantage, would negatively affect my projections.

Corporate Governance

The Board of Directors of JD.com currently consists of five board members. Only a single board member, Liu Qiangdong, is an executive member for the company. The other four members are independent

Executive Members

- Liu Qiangdong, Founder and CEO

CEO and founder Liu Qiangdong was accused of rape in 2018 by a Chinese university student. A trial exonerated Liu of any crime and the charges were dropped. Another rape charge was filed in 2019, the charge seeks compensation and has named both Liu and the company as defendants.

Independent Members

- Martin Chi Ping Lau, President of Tencent
- Ming Huang, Professor of Finance at Cornell University
- Louis Hsieh, Director of New Oriental Education and Technology Group Inc.
- Dingbo Xu, Associate Dean at China Europe International Business School

Investment Summary

My analysis leads us to conclude that JD.com is a financially sound company with several extremely intriguing qualitative business advantages. The company's potential for growth is far greater than its peers in the Chinese e-commerce business. JD.com has recently hit scale and is reaping the benefits of economies of scale. The growth the company has had allows them to control better terms for manufacturers. The large investment into their own logistics business has given them a competitive advantage in the industry in several high growth areas compared to their competitors. Based on my findings I arrived at an intrinsic value of **$140.63** and a margin of safety of **53.6%**. I am confident that this value accurately represents the fair value per share, **extremely undervalued by the markets**. I expect JD.com to continue to shrink their operating margins as well as grow their revenue much greater than the rate at which the Chinese economy grows. Additionally, their strategic investments will begin open them up to a greater breadth of revenue streams. I, therefore, recommend a **strong buy** for JD.com.

***Disclosure**: I maintain a small position in JD.com. My current position is long. I have no intention of modifying this position in the near future.*

I wrote this report myself, and it expresses my own opinion. I am not receiving compensation for it. I have no business relationship with any company whose stock is mentioned in this equity report. This report is written explicitly for the Oregon State Investment Group; however, I hold the right to distribute this document to potential employers or for other educational purposes as a sample of my work.

Signed:

John Davis

[1/7/2020]

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JD.com's 2015-2019 FY 20-F Reports

JD.com's 3Q 2020 Report

Appendix