

SEC Investigation Disclosed

Alibaba's SEC Probe: What's Missing From This Disclosure?

If we alert you to existence of an undisclosed SEC probe, that means we filed a Freedom of Information Act (FOIA) request with the SEC on the company in question and have a response, in black-and-white, on government letterhead that supports our statement. Other interpretative guidance and disclosures appear below.

Analyst Summary: On 24-May-2016, Alibaba Group disclosed what appears to be an informal SEC investigation. This is the first time this matter has been disclosed. Details are scant, leaving the investor unable to adequately assess the risk it poses. Using the template of who/what/where/when/why, we will examine what is missing. Our conclusion is you are left with a risk that management views as material but you cannot analyze. We generally recommend avoiding such scenarios.

Facts of Interest or Concern: The following is Alibaba Group's disclosure from the 20-K filed 24-May-2016 –

Earlier this year, the U.S. Securities and Exchange Commission, or SEC, informed us that it was initiating an investigation into whether there have been any violations of the federal securities laws. The SEC has requested that we voluntarily provide it with documents and information relating to, **among other things:** our consolidation policies and practices (including our accounting for Cainiao Network as an equity method investee), our policies and practices applicable to related party transactions in general, and our reporting of operating data from Singles Day. We are voluntarily disclosing this SEC request for information and cooperating with the SEC and, through our legal counsel, have been providing the SEC with requested documents and information. The SEC advised us that the initiation of a request for information should not be construed as an indication by the SEC or its staff that any violation of the federal securities laws has occurred. This matter is ongoing, and, as with any regulatory proceeding, we cannot predict when it will be concluded. **[emphasis added]**

We've not researched Alibaba Group in the past. Therefore we have no history or documents in our database on this company.

Analyst Observations: Using our template of who/what/where/when/why, we now examine what is missing from the Alibaba disclosure.

- **Who is investigating?** So far it appears just the SEC is investigating which make this a civil matter.
- **What are the issues?** We draw your attention to those words, "among other things" that appear in the disclosure just before the company lists some of the items under investigation. Be careful: We've seen cases where something similar to that term of art was actually cover for matters left out of a disclosure that would really bother investors.

So while you are told the probe pertains to, "among other things: our consolidation policies and practices (including our accounting for Cainiao Network as an equity method investee), our policies and practices applicable to related party transactions in general, and our reporting of operating data from Singles Day", we recommend you press the company to simply tell you what those "other things" are that were left out of the disclosure.

The best question to ask: What are all the matters on which the company has been asked to produce records, information, and/or testimony? The devil could easily be in those details. The company will know the answer and there is usually no restriction on them answering this question.

- **Where does it stand?** If the company is to be believed, the probe started earlier this year. That puts us in the early stages of what could easily become a multi-year investigation. Further, we also note there is just enough ambiguity in the language to have us wondering if this probe is now formal. It's certainly worth asking.
- **When did this begin?** This is one of the most important questions investors need answered. Knowing when it began gives investors a sense of how long it has been going on. That alone is potentially valuable information. For example, if there were negative research reports or news stories circulating in the past, and you see the SEC started a probe shortly thereafter, it's a good bet some of the items in those reports/stories either triggered the SEC probe or are included as part of it.

This is the first time a disclosure relating to this matter has been made by the company. In this case, we are a bit troubled by the language stating the probe started "Earlier this year". How much earlier, exactly? The first time Alibaba had contact with the SEC's Division of Enforcement on this matter cannot be discerned from the disclosure. You really want to know this.

- **Why is the company disclosing this now?** Including the 20-F filed on 24-May, Alibaba made four other official SEC filings this year (29-Jan, 12-Apr, 25-Apr,

and 05-May-2016). Two of them were earnings announcements. For an SEC probe that began, "earlier this year", it sure appears there was plenty of opportunity to disclose this sooner. This instantly begs the question of 'what changed?' That is, for all this time the company did not judge this matter sufficiently material to disclose. Something changed.

The materiality threshold, which is at the core of how we view the world, says that in general companies are only required to disclose matters deemed material and, often to the chagrin of investors, management is the judge.

It's safe to assume that something about this matter caused Alibaba executives to feel compelled to make this disclosure, scant as the details are. Until now, they did not judge this posing a material risk to the company. Now they do, and there is not enough here for you to analyze.

Finally, whenever we examine disclosures from a company where we know there is more information available than the company is providing, it leaves us questioning the overall thoroughness of the company's remaining disclosures and information being provided to investors.

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Notes: *The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced. The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security. New SEC investigative activity could theoretically begin or end after the date covered by this latest information which would not be reflected here.*

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