Alibaba Group

September Quarter 2022 Results

Conference Call

Transcript

Thursday, 17th November 2022

Introduction

Rob Lin

Head of Investor Relations, Alibaba Group

(Original)

Thank you. And good day, everyone. Welcome to Alibaba Group's September Quarter 2022 Results Conference call. With us are Daniel Zhang, Chairman and CEO; Joe Tsai, Executive Vice Chairman; Toby Xu, Chief Financial Officer. This call is also being webcast from our IR section of our corporate website. A replay of the call will be available on our website later today.

Now let me quickly cover the Safe Harbour. Today's discussion may contain forward-looking statements. Forward-looking statements involve inherent risks and uncertainties that may cause actual results to differ materially from our current expectations. For detailed discussions of these risks and uncertainties, please refer to our latest annual report on Form 20-F and other documents filed with the U.S. Securities and Exchange Commission or announced on the website of the Hong Kong Stock Exchange. Any forward-looking statements that we make on this call are based on assumptions as of today and we do not undertake any obligation to update these statements, except as required under applicable law.

Please note that certain financial measures that we use on this call, such as adjusted EBITDA, adjusted EBITDA margin, adjusted EBITA, adjusted EBITA margin, non-GAAP net income, non-GAAP diluted earnings per share or ADS and free cash flow, are expressed on a non-GAAP basis. Our GAAP results and reconciliations of GAAP to non-GAAP measures can be found in our earnings press release. Unless otherwise stated, growth rate of all stated metrics mentioned during this call refers to year-over-year growth versus the same quarter last year.

In addition, during today's call, management will give their prepared remarks in English. A third-party translator will provide simultaneous Chinese translation on another conference line. Please refer to our press release for details.

During the Q&A session, we will take questions in both English and Chinese and the third-party translator will provide consecutive translation. All translations are for convenience purpose only. In the case of any discrepancies, management's statement in the original language will prevail.

With that, I will now turn the call to Daniel.

September Quarter 2022 Highlights

Daniel Zhang

Chairman & CEO, Alibaba Group

(Original)

Thanks, Rob. Hello everyone. Thank you for joining our earnings call today.

We delivered a solid quarter in a macro environment full of uncertainty. The ongoing resurgence of COVID-19, geopolitical tension, inflation, and currency depreciation – the convergence of all these forces has created considerable difficulties for business operations. Despite these challenges, Alibaba's non-GAAP EBITA[1] increased 29% year-over-year as we continued to enhance our operational efficiencies. This is the result of our pursuit of high-quality development and, more importantly, demonstrates the resilience of the Alibaba business ecosystem.

In the China domestic consumer market, Taobao-Tmall GMV[2] saw a low single-digit year-on-year decline this quarter, but user traffic remained stable. However, consumption appetite was weak and we saw a drop in purchasing frequency. The resurgence of Covid has affected one area after another, resulting in abnormal or suspended logistics service in different places. This hurt merchant operations and consumer logistics experience. In terms of demand, the decline in categories such as apparel and consumer electronics slowed quarter-over-quarter. Interest-based categories, such as outdoor recreation and pet care, and health and wellness-related categories, realized positive growth.

In this challenging environment, we have achieved relatively positive results through a committed execution of the following strategies:

1. We worked to ensure our user traffic population remained stable (DAU or MAU) by continuing to strengthen user engagement. After many years of operation, Taobao-Tmall is now deeply entrenched in users' minds as THE shopping destination. We are focused on user engagement on our platform by enhancing the customer journey across search, algorithm-driven discovery recommendations, livestreaming, and other engagement features. We stimulated consumption interest and drove conversion by highlighting the factors that influence purchase decisions through short-form videos, photos, text, and other means of communication.

2. We further consolidated the scale and stickiness of our most valuable consumer group. For the twelve months ended September 30, 2022, the number of consumers who each spent over RMB10,000 on Taobao and Tmall remained around 124 million with a

[1] "Non-GAAP EBITA" refers to "Adjusted EBITA".

[2] "GMV" refers to online physical goods GMV excluding unpaid orders.

retention rate of 98%. 88VIP membership population held steady at 25 million this quarter, with solid membership retention and growth in GMV contribution.

3. We improved consumer satisfaction by continually investing in customer service during and after sales, and logistics service experiences such as doorstep delivery of orders as required. Our latest consumer satisfaction survey showed improvements in NPS scores related to logistics and post-sales.

During our recent 11.11 Global Shopping Festival, Taobao-Tmall's total GMV was in line with the performance last year during the same period. Initial fruits of the operations strategy outlined just now were seen during 11.11: More than 600 million users engaged with our 11.11 related content, a single-digit growth year-over-year. Although the total number of buyers declined compared to the same period last year, the average GMV per person increased. As for our consumer profile, more than 98% of 88VIP members bought something during the 11.11 season. Moreover, the contribution by 88VIP members to the total GMV continued to grow.

Regarding product categories, consistent with what we observed during the rest of the quarter, interest-based categories such as outdoor recreation and pet care and health and wellness-related categories saw positive growth. Consumer electronics also enjoyed positive growth during the 11.11 season. However, there were a few factors that negatively impacted our 11.11 performance:

1. Average temperature across China was much warmer than usual for that time of year, and the delay in seasonal change weakened consumption appetite for apparel even more in an environment impacted by Covid. Thus the apparel category suffered.

2. Starting in October and through the 11.11 campaign period, nearly 15% of delivery areas across China experienced abnormal or suspended logistics service. This had a significant impact on the merchant's ability to fulfill orders on time and the delivery company's ability to make regular deliveries. But recently we are seeing improvements.

3. 11.11 has become an event celebrated and embraced by the entire society. Given the uncertainties related to Covid-19, merchants were especially keen to take advantage of this opportunity to capture as much growth as possible across every available channel. Objectively speaking, they offered consumers more choices, both online and offline.

This quarter, the decline in Customer Management Revenue was higher than the decline in overall GMV. I would like to share the reasons. The first is a higher rate of order return because of:

A. Order returns due to Covid-related impact on fulfillment and delivery;
B. A higher order return rate that accompanies livestreaming-driven sales;
C. The increasing convenience of making returns and improvements in user experience in returns handling on our platform.

These three reasons collectively contributed to the rise in order return rate across the platform. CMR take rate calculation does not account order returns. If it was accounted for, our take rate actually remained consistent. Additionally, page views from algorithm-driven discovery recommendations grew, but our monetization of traffic was less efficient, resulting in a lower take rate in the short term. Looking forward, we will adapt to the changes in our user traffic composition and introduce better monetization products to ensure the long-term stability of our platform take rate.

In our local consumer services segment, Ele.me proactively adjusted its business operations strategy to focus on user growth and retention on its mobile app. And it continued to grow its market presence in key cities. At the same time, it continued to enhance operational efficiency and unit economics continued to see improvement. This is primarily due to the rise in average order value, leading to an increase in revenue and a reduction in logistics costs for order fulfillment.

Amap launched a new version of its map this quarter, together with a series of new features, including a 3D city map, car lane-level road navigation, forecasting of traffic light signals, and road navigation for staying in the shade out of the sun, etc. User population and stickiness continued to strengthen, and a new historical record of 220 million DAU was registered during the week of the National Day holidays. On top of its map navigation, the services offered by Amap related to getting "to destination" - which include ride-hailing, hotel booking, gas stations, and EV recharging stations - are all experiencing rapid development, with both service users and order volume enjoying fast growth.

Cainiao's various businesses saw robust growth in this quarter and there were clear improvements in cost efficiency. The Cainiao Post network grew by 20% year-on-year and now has more than 170,000 locations. It has comprehensive coverage in residential communities, school campuses, and rural villages across China. Cainiao Post has become an important touch point for serving consumers. For overseas markets, Cainiao continued to actively build logistics hubs and nodes to further enhance its global logistics network’s service capabilities and efficiencies.

In overseas markets, the rise in logistics costs due to inflation and currency depreciation against the US dollar has contributed to order volume decline of 12% year-on-year in our cross-border export business AliExpress. In Southeast Asia, Lazada order volume declined 6% year-on-year as Covid-related restrictions were lifted and offline shopping resumed. Trendyol’s order volume grew over 65% year-on-year on the strength of its e-commerce business and fast-growing local consumer services. For AliExpress and Lazada, we are taking steps to adjust our business model and investing in creating user value rather than just scaling. We are also continuing to strengthen our capabilities in logistics and supply chain. We believe that developing and investing in these capabilities will be meaningful to ensuring the sustainable long-term development of our abilities to serve the overseas consumer market.

In our cloud segment, Alibaba Cloud’s revenue growth was 4% year-on-year this quarter. Through structural adjustments over the past few quarters, Alibaba Cloud’s revenue structure is now healthier and more sustainable. Public cloud revenue grew double digit year-on-year this quarter, while hybrid cloud declined. In the interest of pursuing higher quality growth, we proactively controlled the development of our business that only resells hosting infrastructure that has been commoditized in the market. Looking at our revenue by industry, non-Internet industry revenue grew 28% year-over-year. Its contribution to total revenue increased from

53% to 58% quarter-over-quarter. The fastest growing sectors include financial services, automotive, telecom, and public services. Looking ahead, Alibaba Cloud will leverage its proprietary cloud computing and big data processing capabilities to launch a range of industry solutions with relevant partners for advancing China's industrial digitalization. At the Apsara conference in early November, we unveiled many important technological achievements. It included our Cloud Infrastructure Processing Unit (CIPU) and an open-source platform under the Model-as-a-Service named Model Scope. These will serve important purposes in Alibaba Cloud's future development.

In this environment full of uncertainty, our wide-ranging efforts in cost reduction and efficiency improvement measures are beginning to bear fruit. Businesses such as Taobao Deals, Taocaicai, Ele.me, Amap, Lazada, and Youku have significantly reduced their losses. We will continue to focus on the steady improvement of business quality and on investing in building capabilities to provide customers core value rather than pursuing short-term business growth or user scale. As China enters an era of high-quality development, we will also enter a stage of high-quality business operations.

During the eight years from Alibaba's IPO in September 2014, the quality and scale of our business has improved significantly. Alibaba's revenue today is 12 times what it was during the same period in 2014. Adjusted EBITA is 4.5 times what it was during the same period in 2014. Free cash flow is four times that of what it was in 2014. Over the past eight years, China's GDP has almost doubled, from RMB59 trillion in 2013 to RMB114 trillion in 2021. We are confident about the future and we will continue to execute our share buyback program. As of November 16, we have utilized approximately USD18 billion to date towards share repurchase under our existing USD25 billion program, with USD7 billion more to go. In addition, our board has authorized us to upsize our existing share repurchase program by another USD15 billion as a tangible action toward enhancing shareholder return.

We remain confident about ourselves and even more about the future, no matter the ups and downs. We believe in the prospects of China's economic and social development. We believe Alibaba's development goals are highly aligned with China's long-term goals. We believe Alibaba can play an important role in the digitalization process in China and around the world. We have taken note of the latest adjustments in China's Covid-related policies and the proactive commentary from relevant government regulators about promoting the digital economy and high-quality development of platform businesses. We believe that Covid will ultimately pass, that our society, our economy, and our lives will eventually return to normal, and that the massive potential of China as the world's second-largest economy will be further unleashed. Last but not least, we believe that the platform economy that Alibaba is part of can make unique and valuable contributions toward serving small and medium businesses, creating employment, and the pursuit of better lives.

Thank you, everyone. Let me pass the microphone to Toby, who will share our financial results with you.

Financial Highlights

Toby Xu

CFO, Alibaba Group

(Original)

Thank you, Daniel. Let me start with financial highlights for the quarter.

This quarter, our total revenue was RMB207 billion, an increase of 3% year-over-year. Income from operations for the quarter was RMB25.1 billion, an increase of 68% or RMB10.1 billion year-over-year, mainly driven by increase in adjusted EBITA of RMB8.1 billion and decrease in share-based compensation expense of RMB2.3 billion. During September quarter, we have continued to improve operating performance of our loss-making businesses by enhancing operating efficiency and optimizing costs that resulted in 29% year-over-year increase in adjusted EBITA to RMB36.2 billion. Overall adjusted EBITA margin improved by 3 percentage points to 17%.

Now let’s look at cost trends as a percentage of revenue excluding SBC. Cost of revenue ratio remained stable at 63% in September quarter. Our direct sales businesses and logistics services continued to grow, driving up our cost of inventory and logistics, but we were able to keep our cost of revenue ratio stable primarily through optimizing traffic acquisition and improving subsidy efficiency. Product development expenses ratio remained stable during the quarter. Sales and Marketing expenses ratio decreased 2 percentage points year-over-year to 11%, reflecting our continued efforts in optimizing user acquisition and user retention spending across our businesses. General and administrative expenses ratio remained stable at 4% in September quarter.

Non-GAAP net income was RMB33.8 billion, an increase of RMB5.3 billion year-over-year, mainly due to increase in adjusted EBITA, partly offset by the decrease in equity pickup of our equity method investees’ results. Our GAAP net loss was RMB22.5 billion, a decline of 25.8 billion year-over-year, primarily due to the increase in net loss arising from changes in fair value of our equity investments, partly offset by increase in non-GAAP net income.

As of September 30, 2022, we continue to maintain a strong net cash position of 323 billion RMB or 45 billion USD. Our strong net cash position is supported by healthy cash flow generation. In September 2022 quarter, cash from operating activities was RMB47 billion and free cash flow were RMB36 billion, respectively, which were up by RMB11 billion and RMB13 billion vs. a year ago. Majority of the difference between operating cash flow and free cash flow is operating CAPEX at RMB11 billion, down by RMB1.7billion vs. a year ago. Net cash outflow for investments and acquisition activities, net of inflow from disposals, significantly reduced to RMB2.4 billion compared to RMB21.5 billion[3] in the same period last year.

[3] “RMB21.6 billion” was mistakenly stated as “RMB21.5 billion”.

Importantly, under current market conditions, and given the confidence we have in the long-term sustainability of our business, we have been repurchasing our shares aggressively. For the fiscal first half ended September 30, 2022, we repurchased approximately 62.9 million of our ADSs for approximately USD5.6 billion, which is equivalent to about 70% of our free cash flow during the period. From October 1st to November 16th, we have repurchased another USD2.6 billion in ADSs under our share repurchase program. Our strong balance sheet and free cash flow give us the flexibility to execute this share repurchase program with confidence.

Now, let’s look at our segment results.

Revenue from China commerce segment in September quarter was RMB135 billion, a decrease of 1% year-over-year. Customer management revenue decreased by 7% year-over-year to RMB66.5 billion. Taobao and Tmall physical goods paid GMV[4] declined by low-single-digit[5]. Customer Management Revenue is composed of advertising and commission revenue. Within advertising, search advertising revenue continued to observe positive growth as it provides consistent return for merchants, while non-search advertising is negatively impacted by overall macro conditions and other factors. Commission revenue also declined more than that of Tmall paid GMV due to higher order cancellations.

Direct sales and others revenue grew 6% to RMB65 billion, primarily driven by strong growth of our Freshippo and Alibaba Health’s direct sales businesses.

China Commerce Segment Adjusted EBITA increased by RMB2.6 billion to RMB44 billion in the quarter. The improvement reflected significant loss reductions from Taobao Deals, Taocaicai, and Freshippo, which, on combined basis, reached RMB4.9 billion in September quarter.

Segment EBITA margin improved 2 percentage points year-over-year to 32% during this quarter. Segment EBITA margin can be further separated into three types of businesses: First, our existing marketplace businesses including Taobao and Tmall continue to exhibit stable EBITA margin year-over-year. Second, combined EBITA margin of our direct sales businesses continues to improve, which was primarily driven by Freshippo. During the quarter, vast majority of Freshippo’s existing stores have achieved cash flow positive. Lastly, new businesses including Taobao Deals and Taocaicai significantly reduced losses year-over-year as previously mentioned

Our International commerce segment revenue in September quarter was RMB15.7 billion, an increase of 4% year-over-year. Revenue from International commerce retail business increased by 3% to RMB10.7 billion. The increase was primarily driven by Trendyol as a result of its strong order growth of over 65%, partly offset by the decrease in AliExpress order as a result of challenges faced in cross-border e-commerce demand in Europe due to depreciating Euro and increasing logistics costs. Revenue from our Alibaba.com wholesale business grew 6% to RMB5.0 billion. The increase was primarily due to resilient 8% growth in value of transactions

[4] “Physical goods paid GMV” refers to “online physical goods paid GMV.”

[5] “Declined by low-single-digit” refers to “declined by low-single-digit year over year.”

completed on Alibaba.com that lead to an increase in revenue generated by cross-border related value-added services.

International Commerce Segment Adjusted EBITA loss narrowed by RMB1.5 billion to RMB960 million in September quarter. The significant loss reduction year-over-year was primarily contributed by the reduced losses from Lazada and Trendyol.

Lazada has continued to improve monetization rate as well as enhancing operating efficiency. During the quarter, loss per order for Lazada narrowed by over 25% compared to the same period last year. While Trendyol's improvement is a combination of strong revenue growth despite FX headwind as well as enhanced operating efficiency.

Our Local consumer services segment revenue in September quarter grew 21% to RMB13 billion, primarily driven by strong revenue growth of Amap, as well as higher average order value and more efficient use of subsidies that were contra revenue of Ele.me.

Local consumer services Adjusted EBITA loss reduced by RMB3 billion year-over-year to RMB3.5 billion. Most of the loss reduction was driven by Ele.me business, while rest of the other businesses also recorded reduced losses.

Ele.me continued to improve its unit economics (UE) per order by increasing average order value, reducing delivery cost per order and optimizing user acquisition spending. Its UE continued to improve year-over-year and remained positive this quarter.

Revenue from Cainiao, after inter-segment elimination, grew 36% year-over-year to RMB13.4 billion, primarily contributed by the increase in revenue from domestic consumer logistics services as a result of service model upgrade since late 2021 to enhance consumer experience, and also international fulfillment solution services revenue increased. In September quarter, 73% of Cainiao's total revenue was generated from external customers.

Cainiao recorded adjusted EBITA profit of RMB125 million in September quarter, an increase of RMB440 million year-over-year.

Revenue from our Cloud segment, after inter-segment elimination, was RMB20.8 billion in September quarter, an increase of 4% mainly driven by healthy public cloud growth, partially offset by declining hybrid cloud revenue as we continue to drive high-quality, recurring revenue growth.

Revenue growth from non-Internet industries continued to accelerate, growing 28% and contributed 58% of overall Cloud revenue. Strong revenue growth of the non-Internet industries was driven by financial services, telecommunication, and public services industries.

Revenue from customers in the Internet industry declined by 18% that was mainly driven by declining revenue from the top Internet customer that has gradually stopped using our overseas cloud service for its international business, online education customers as well as softening demand from other customers in China's Internet industry.

Adjusted EBITA of Cloud segment, which comprised of Alibaba Cloud and DingTalk, was a profit of RMB434 million in September quarter, increased by RMB38 million year-over-year.

Revenue from our Digital media and entertainment segment in September quarter was RMB8.4 billion, an increase of 4% primarily due to the increase in revenue from Alibaba Pictures, Youku, which was partly offset by decrease in online games business revenue.

Adjusted EBITA was a loss of RMB117 million, reduced by 814 million year-over-year, primarily driven by narrowing of losses for Youku and improved profitability of Alibaba Pictures. Youku continues to improve operational efficiency through disciplined investment in content and production capability. Its year-over-year losses have been narrowed for six consecutive quarters.

Over the past several months, we have been preparing for our primary listing in Hong Kong. During this process, we are closely monitoring and taking into account various factors, including changing market and other external conditions.

Before our conversion to primary listing in Hong Kong, we also need to formulate and submit a new employee stock ownership program ("ESOP") to our shareholders for approval in order to comply with the newly amended rules in Hong Kong. The new ESOP program will continue to align the development of our Company with the interests of our long-term shareholders.

Accordingly, we will not complete the primary conversion before the end of 2022 as initially planned. We will continue to evaluate the various factors during this process and update our investors in due course.

To wrap up, since I've taken up the CFO role earlier this year, I have met many shareholders and I really appreciate all of your feedback. As I have communicated to many of you, we will proactively execute our capital allocation strategy to create and unlock our company's intrinsic value. We consider three important factors:

First, we will be focused. We will not only continue to execute our "Three Growth Pillar Strategy" but will also prioritize growing businesses that improve our medium to long-term revenue growth and profitability profile. We remain confident of the growth prospects of our businesses, many of which are leading players in their respective markets.

Second, in order to optimize our capital resources, we will continue to be more selective in M&A activities, monetize less strategic investments and unlock the value of selected subsidiaries.

Lastly, we want to better align our business performance to the interests of our long-term shareholders. During each of FY22 and fiscal 1H23 period, we have deployed around 70% of free cash flow to share buybacks. As of November 16, 2022, we had repurchased approximately USD18 billion of our shares under our existing USD25 billion share repurchase program. In addition, our board of directors has approved to increase our existing share repurchase program by another USD15 billion and extend the program through the end of March 2025. Currently, we have an un-utilized amount of USD22 billion under our upsized and extended share repurchase program.

We hope our ongoing and consistent share repurchase program will deliver attractive and consistent return to our long-term shareholders, especially during this period of extreme market volatility.

Thank you. Now let's turn to Q&A.

Q&A

Rob Lin:

(Original)

Hi, everyone. For today's call, you are welcome to ask questions in Chinese or English. A third-party translator will provide consecutive interpretation for the Q&A session. And our management will address your question in the language you ask. Please note that the translation is for convenience purpose only. In the case of any discrepancy, our management statement in the original language will prevail. If you are unable to hear the translation, bilingual transcripts of this call will be available on our website within one week after the meeting.

Ronald Keung (Goldman Sachs)

(Translation)

Thank you, Daniel, Toby, Joe, and Rob. My question has to do with customer management revenue (CMR) and management's outlook on domestic GMV and take rates. You stated that GMV during 11.11 this year was consistent with last year's. So there's been some improvement from the single digit drop in the September quarter. But at the same time, we've observed a year-on-year drop in November's postal parcel volume. How should we understand these recent trends? Looking forward to the next several quarters, if the COVID situation and the macro environment stabilize, should we expect to see year-on-year GMV and CMR growth turn positive? Thank you.

Daniel Zhang:

(Translation)

Thank you. Let me take this question. In my prepared remarks, I presented detailed analysis of the CMR issue as I know this is a topic of great interest to investors. When we look at GMV today, in the context of the pandemic and of ongoing changes in the ways of e-commerce operation, marketing, and sales, in particular with the rapid development of livestreaming, there has been an impact on overall returns of purchases on the platform. So typically when we talk about CMR, we discuss CMR in conjunction with take rates. However, there are some differences between these two factors.

First of all, when it comes to take rates within CMR, part of that is based on actual merchant GMV after returns. So that part is going to be highly correlated with return rates. Secondly, in terms of advertising revenue within CMR, this is linked to the macro environment, advertisers' willingness to invest, and the overall business performance of our merchants.

Third, from Alibaba's perspective, CMR should really be a result of all of the efforts that we make to help merchants better engage consumers on the platform and drive their sales. Be it page search, with which everyone is very familiar, smart recommendations, which is a more recent development, or livestreaming, which has grown very rapidly of late, these are all different ways that we enable merchants to better engage their consumers and to drive their sales, which ultimately will result in increased CMR.

On this journey, we are very clear about the way forward and the future prospects. Thank you.

Thomas Chong (Jefferies):

(Translation)

Daniel spoke earlier about several factors that affected performance during this year's 11.11. The first was the impact of logistics issues, which we saw were quite serious in Guangdong and around the country. So I'm wondering, looking at the December quarter, how would you rank the impact of these different factors? The impact of logistics issues will be order cancellations, or returns. But how would you rank the three different factors, i.e. consumer sentiment, the impact of the pandemic on logistics, and returns of goods in connection with livestreaming, in terms of their impact on CMR or on GMV?

And then secondly, we see that the China Commerce segment achieved strong results in terms of EBITA, with a 6% increase. Given the uncertainty in the macro environment in the short term, if CMR is impacted by these macro factors, how large an impact will that have on EBITA? Thank you.

Daniel Zhang:

(Translation)

First, as regards those three situations, or three factors that you summarised in your question, their relative impact is in flux. The most fundamental, if we were to rank them --- and this would be true for any enterprise or any platform --- would be the macro-economic environment that we find ourselves in, which creates headwinds or tailwinds, most importantly with respect to consumer confidence and willingness to spend. I see that as the most fundamental point, and the number one factor affecting not just Alibaba, but overall retail consumption nationwide, and all the players in the consumption space both online and offline.

Second, as I recently noted, the introduction of China's 20 new measures [for optimizing COVID-10 response] can be expected to have a positive effect on the availability of logistics services. We're already seeing some progress, with some partial improvement. Despite ongoing disruption to logistics, and even unavailability in certain regions of the country at present, overall, we do expect the situation to see further improvement.

The third factor is livestreaming becoming a more important sales format, and the resulting impact on returns. However, relative to our peers, especially those who primarily rely on livestreaming or who only have livestreaming, I think the impact on Alibaba is much smaller. That's because livestreaming accounts for a much smaller proportion of our sales. And secondly, although livestreaming played a more important role on Alibaba during the 11.11 period than it does during the regular periods of the year, especially as regards pre-sales for 11.11, nonetheless in our regular operations outside of those large-scale campaigns, livestreaming is just one sales format that merchants can leverage on Alibaba, not the entirety of their business.

Alibaba is working hard to balance these different formats to ensure that merchants are able to engage with their consumers in ways that consumers like and that are cost effective for merchants. As an e-commerce platform, Alibaba is always open to embracing new technologies, while ensuring that balance between good consumer experience and acceptable, sustainable costs for merchants.

Toby Xu:

(Translation)

I'd like to quickly respond to your second question about whether the reduction in CMR revenue will have an impact on the profit of the China Commerce segment going forward. A reduction in any revenue stream would of course have an impact on profit at the end of the day. However, if you look at China Commerce EBITA in this quarter, it was up as compared against both the previous quarter and the same quarter last year. We achieved that primarily by being very disciplined in our spending and investment and also by driving higher levels of efficiency. As a result, we successfully increased profitability in the profit-making businesses and narrowed losses in the loss-making businesses, thus realizing an EBITA increase of around six percent.

Eddie Leung (Bank of America):

(Translation)

Good evening, management. I'd like to ask a hypothetical question. Assuming there were to be a large directional adjustment in pandemic control measures in China, how big an impact, positive or negative, would you expect that to have on different product categories? And are there any preparations that Alibaba could be making as a company to better position itself for that future prospect of a major change in pandemic control restrictions. Thank you.

Daniel Zhang:

(Translation)

Thanks, Eddie, for this really good question. I'm sure that we all hope to see the earliest possible end to the pandemic and a complete return to normalcy for society, for the economy, and for our own daily lives. Were the pandemic to ease, allowing economic activity to pick up and daily life to improve, that would be good news for Alibaba, and it would be good news for everyone. Of course, because Alibaba’s businesses are so diverse, they would be impacted in different ways.

With respect to the consumption part of our business, I think most importantly, an easing of the pandemic and return to normal life --- and to normal work in particular, meaning more jobs --- would result in a boost to consumer confidence. That would certainly be positive for the Chinese economy as a whole and also for companies like Alibaba. Consumption is an important engine of economic growth. Of course, for consumers to spend, they need to have confidence in the future. They need to have stable expectations of the future, including of their own future income. So an improvement in the pandemic situation would have a positive effect on those expectations, and on confidence, which would stimulate consumption.

Of course, there would also be changes in the consumption mix. As we can see today, throughout the pandemic and despite all the uncertainty, demand has remained strong for nondiscretionary consumption of daily essentials like food, groceries, and household necessities. There’s even been demand for stocking up in these categories, as people have been worried about potential supply disruptions, and lack of access to daily essentials. Were the pandemic to ease, then I think a lot of those worries would be dispelled. But at the same time, I think demand for non-essential items would increase. With a return to normal life, the larger trend would be consumers’ aspiration for and pursuit of a better life. So I think we would see a boost in demand for non-essentials like apparel and fashion.

For our 2B businesses like cloud, I think a crucial point to note is that all enterprises across the board understand that digitalization is the future, and they all want to be a part of that future. But to a large extent, any company’s willingness to invest in digitalization is a function of whether their business operations are normal and whether they are growing. All companies need to manage their spending and live within their means. So, I think an easing of the pandemic would be good news, as a return to normal operations and business growth would make companies more willing to devote more resources to digitalization.

For Alibaba, I think it's important that we always be looking forward, holding out hope for the post-pandemic future and making active preparations in that connection. In terms of consumption categories, we already have a very complete offering and are actively making preparations to develop and roll out new categories for the post-pandemic era, not just in terms of goods, but also services, including in sectors like travel and tourism.

In the cloud space, we are also working actively to promote the process of digitalization and to develop new products and services for different verticals, to enable customers to generate data, to leverage their data, and to generate value from their data. We need to continue to be fully prepared to do that going into the future.

Alex Yao (JPMorgan):

(Translation)

Thank you, management. Daniel, in your prepared remarks, you spoke about how Alibaba's long-term development is highly aligned with China's long-term objectives and said that Alibaba will actively participate in China’s digitalization. I'm wondering, in the context of the current political and regulatory environment, how you see digitalization playing out in China going forward, say, over the next five years, in terms of its direction and its pace. And what can Alibaba do as part of that process, and what the financial returns will look like? Thank you.

Daniel Zhang:

(Translation)

Well, when it comes to the big picture of the future, we have a clearly articulated vision. Our three key strategies are cloud computing, consumption, and globalisation. We do closely study national development strategies, and note the high degree of alignment between our own strategies and the development objectives set by the Twentieth Party Congress, in particular to build China into a strong player in Internet industries and a strong digital economy.

As I recently pointed out at the World Internet Conference in Wuzhen, over the past twenty-three years, Alibaba’s first contribution was the digitalization of retail commerce, leveraging digital technology to enable the circulation of goods in the real economy, with better distribution and sales channels to serve consumers. And in order to accomplish that, we also built a logistics system underpinned by digital technology. This enables goods to circulate efficiently all around the country, leveraging highly efficient supply chains. In fact, China is now the most developed market in the world for express delivery services, in terms of both parcel volumes and service quality.

And then thirdly, over the last five to ten years, we've been very focused on investing in cloud computing. It is our firm conviction that the digitalization of the real economy is the future across all industries. Today, digital solutions are being widely adopted in pandemic prevention, and across all industries and sectors, from public services through urban management, and by companies in all sectors of the economy. And there is a high degree of consensus around this development.

So, going forward, it is Alibaba's firm conviction that we will continue to serve the digitalization of China's real economy, leveraging digital technologies to drive long-term growth. At the same time, we will continue to improve our technology capabilities and leverage cloud computing to allow technology to better serve the real economy and to serve the process of industrial digitalization.

So in this regard, we have strong confidence in Alibaba's ability to participate in and contribute to the realization of these national development goals. We are also highly encouraged by the recent announcement of a series of new policies by the central government, including on the development of the platform economy. Alibaba looks forward to further contributing to this development process and to playing our due part in promoting China's development, promoting the development of the real economy, and empowering the real economy. Thank you.

Jerry Liu (UBS):

(Translation)

Thank you, management, and good evening. I'd like to come back, if we could, to a topic we addressed earlier in the discussion, namely that of take rates. Daniel said that part of the issue is return rates, and another part is user traffic. As efficiency may not be ideal, there may be some consideration and some actions to increase traffic monetization going forward. I'm wondering if you could tell us, please, what adjustments or improvements we will be seeing over the next few quarters or say over the next year, in terms of the company's ability to monetise traffic. Thank you.

Daniel Zhang:

(Translation)

The topic of monetising traffic is one of perennial interest, of course, to investors and we've taken many questions on this topic over the years. But for Alibaba, it's not something that we look at in isolation. For us, it's really about how our products can help merchants engage consumers and create value for their business. Only by creating value for merchants, allowing them to achieve a good ROI, can we earn our share of that ROI. So that's our basic objective.

Secondly, when you look at our matrix of consumer apps, centred on the Taobao mobile super app, today there's more diversity in terms of the way consumers are interacting, and more different routes to purchase, as I mentioned in my earlier remarks. We have search, which serves consumers with a specific purchase intent in mind. And over the past few years, we have developed highly effective recommendation feeds, supporting consumer discovery. And today, we also have livestreaming and short-form videos as a new consumption format. As the concentration of consumers in these consumption scenarios increases, as frequency, or traffic, increases, we can implement plans and take steps to monetize that traffic. But at the end of the day, monetization really comes down to our ability to empower merchants to engage consumers, be it via search, via recommendations, or via video. That is the way forward.

So as I said earlier, as we continue to develop discovery tools, we are seeing structural growth in consumer usage and page views. We will continue to look closely at these developments and look at ways to monetize accordingly. At the end of the day, it’s really about consumers, and providing a reliable service to merchants to help them engage consumers.

Alicia Yap (City Group):

(Translation)

Good evening, management. Thanks for taking my question. By way of follow-up, could you tell us about the changes you’re seeing in terms of how large brands and long-tail merchants have been allocating their advertising budgets over the past few months, versus pre-COVID? For example, what proportion of their marketing budgets are they allocating to search versus recommendations? Are there any differences between large merchants and small- (or long-tail) and medium-size merchants? And what changes have you seen from pre-COVID through to the present?

And further to that, Daniel spoke about how livestreaming is opening up a new marketing model that is more convenient for merchants and makes for multiple formats. But when it comes to the platform’s take rate, is it the case that livestreaming has a lower take rate than search and recommendations?

Daniel Zhang:

(Translation)

Okay, let me take the two questions one by one.

First, when it comes to marketing budgets, and I think this is true of all kinds of merchants, large, medium or small, in the context of a pandemic and considerable uncertainty, what we’ve seen overall is a more prudent approach to spending on marketing. Any company, regardless of its size, is going to allocate its marketing budget as a percentage of its expected future revenues, be it for the quarter or for the year as a whole. So in a period of heightened uncertainty around future revenues, all companies --- small, medium, or large --- will tend to be more prudent in relation to their marketing budgets.

I think secondly, the biggest change we’ve seen is merchants seeking higher levels of marketing effectiveness. Merchants are probably more demanding now than ever before in terms of ROI. Merchants have become more cautious about investing in pure brand advertising and display advertising, as opposed to performance-based advertising. And they are demanding higher levels of ROI from performance-based advertising. Merchants are looking for more certainty amid all of the economic uncertainty brought about by the pandemic.

So that's my answer to your first question. Alibaba is, of course, very well positioned as both a consumer media and also a platform for merchant operations. As such, we support sustainable merchant operations --- not with one-off campaigns, but with a methodology and a profit model for ongoing, sustainable business. That's why Taobao and Tmall continue to be the primary place of choice for merchants to come and do business. And this has become even more important today in the context of the pandemic.

Of course, merchants are always going to explore new platforms and new formats that crop up, because they're always looking to achieve incremental growth in their business. But at the end of the day, they will be looking carefully at the stability of the ROI they're achieving and the sustainability of the investment they're making to gain that incremental new business.

Your second question had to do with the take rate on livestreaming. Actually, Alibaba has two different kinds of livestreaming. The first kind is merchant livestreaming. This is where a merchant has an online store on Alibaba from which a merchant employee or a third party engaged by the merchant runs their livestream in-house. Merchant livestreaming is unique to Alibaba. The second kind of livestreaming is livestreaming by opinion leaders, or "da ren" as we call them in Chinese. These KOLs run their own livestreams and act purely as promoters, helping different stores to engage consumers. Under both of these models, we have commercial agreements in place that allow us to share in the revenues generated, so there is a take rate with respect to those revenues.

However, the share of livestreaming in our overall business is not highly relevant to the size of monetization revenue of Alibaba as a platform.

Jiong Shao (Barclays):

(Translation)

Good evening, and thanks to management for taking my question. I'd like to ask about Cainiao, which we see has achieved very strong performance this quarter, with revenue growth of over 30%. In the press release you briefly set out a couple of reasons, but I'm wondering if you could expand on what has driven that strong growth?

Also relevant to Cainiao, Toby has talked about unlocking shareholder value. Given that 73% of Cainiao's revenue is now coming from external customers, what's your thinking on the possibility of a potential spin-off?

Toby Xu:

(Translation)

Thanks for the questions. I'll take the first one and then hand over to Daniel to address the second.

The first question had to do with Cainiao's revenue growth. Indeed, in this quarter, Cainiao's revenue increased by 36% year-over-year. In my prepared remarks, I explained that there were basically two components to this growth. The first was in the domestic market, where consumer logistics services saw relatively fast growth. The second was growth in cross-border logistics revenue. A large part of the growth was from local consumer logistics services. And as I mentioned earlier, much of that growth was driven by our service model upgrade. Our previous model was basically what you would call a 3PL model, whereas now we have evolved into a 4PL model. So in the past, our model was just to connect service providers with the end customer. But now we are increasingly purchasing services from the service providers in order to directly serve the end customer. That means we're taking on more responsibility and are able to provide better service experience to our customers. As a result of this service model upgrade, we are able to generate more revenue. So the growth in revenue is a result of this upgrade we've made to our revenue model. With this new model, we have upgraded the service we provide to customers while, at the same time, satisfying regulatory requirements in the logistics sector.

Daniel Zhang:

(Translation)

Let me take the second question. From its establishment in 2013, as an Alibaba-controlled subsidiary within the Alibaba Group, Cainiao has always operated as an independent company. That is extremely clear. Cainiao is independent not just because it has external customers, but, more importantly, because it has external shareholders. As we disclosed in our annual report, Alibaba currently owns 66 to 67 percent of Cainiao's shares. Over the years, our teams have worked hard to build up Cainiao's capabilities, from last-mile consumer touchpoints --- city, countryside, and community posts, campus posts, rural posts --- to logistics supply chains, from domestic to international. We aim for Cainiao to achieve better growth, as an independent company, and trust that Cainiao's continued growth will also feed back into Alibaba's other digital commerce businesses, including both our domestic commerce business and our international commence business, and including both retail commerce and B2B alike. This creates synergy across Alibaba's different businesses. But Cainiao will certainly continue to operate independently and achieve solid development as an independent company serving customers in the market as a whole.

Rob Lin:

(Original)

Thank you everyone for participating in today's earnings call. Today's call will have a transcript available later on our corporate website. Please feel free to reach out to me and our team for follow up. We will see you next quarter. Thank you.

[END OF TRANSCRIPT]