Alibaba Group

June Quarter 2022 Results Conference Call

Transcript

Thursday, 4th August 2022

Introduction

Rob Lin

Head of Investor Relations, Alibaba Group

(Original)

Good day, everyone, and welcome to Alibaba Group's June Quarter 2022 Results Conference Call. With us today are Daniel Zhang, Chairman and CEO; Joe Tsai, Executive Vice Chairman; Toby Xu, Chief Financial Officer. This call is also being webcasted from the 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 the risks and uncertainties, please refer to our latest annual report on Form 20F and other documents filed with the US SEC, 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 are using 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 the 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 a third-party translator will provide consecutive translation. All translations are for convenience purpose only. In the case of any discrepancy, management's statement in the original language will prevail.

With that, I will now turn to Daniel.

June Quarter 2022 Highlights

Daniel Zhang

Chairman & CEO, Alibaba Group

(Original)

Hello everyone. Thank you for joining our earnings call today.

We have delivered stable results after overcoming challenges in an extraordinary quarter. According to data released by the National Bureau of Statistics, China's GDP grew by 0.4% in the past quarter, lowest since the outbreak of the pandemic. Retail sales decreased year-over-year in April and May due to the resurgence of Covid-19 in Shanghai and other major cities, and has slowly recovered in June. Despite the soft economic conditions, we managed to deliver stable revenues and narrowed losses in our several strategic businesses by improving operating efficiency.

In response to these external macro uncertainties, our guiding principles have been, as I wrote in my annual letter to shareholders, "be confident, be flexible and be ourselves." We are confident about the future of the digital economy. We are confident that digitalization as a universal trend across industries and markets will constitute an increasing percentage of the social economy. "Be flexible" means actively adapting to the external challenges and finding our own path through the social and economic development cycles. "Be ourselves" means focusing on our three core strategies, namely Consumption, Cloud and Globalization, and delivering high-quality growth with ESG as the foundation for reaching our vision of becoming a good company that lasts 102 years.

More specifically, we are executing our three core strategies and delivering high-quality growth in the highly uncertain environment today in the following ways: On Consumption, we are leveraging our strength, which is our digital commerce infrastructure built on comprehensive fulfillment capabilities to serve diverse consumer segments, and focus on consumption categories with higher certainty of demand. We already achieved the target of 1 billion annual active consumers in China during the last fiscal year. Going forward, we will focus on growing our wallet share in different consumer segments, instead of pursuing further absolute increase in our user base in China. On Cloud, we will focus on enhancing our competitive advantage which is our proprietary technologies, and serving the sectors and customers that represent the future in social and industrial development. On Globalization, we will focus on the markets with favorable economic development prospects in the next 5-10 years, investing in localized capabilities and building infrastructure in logistics and cloud.

During the past quarter, Taobao and Tmall's GMV[1] experienced a mid-single-digit percentage decline on a year-over-year basis. We saw signs of recovery since June as logistics and the supply chain situation gradually improved after COVID-restrictions eased. Over the past few months, daily active users and consumption-related pageviews of our Taobao app remained

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

relatively stable despite the market volatility. Consumers with the highest spending power demonstrated strong loyalty to our platforms. In the twelve months ended June 30th, 2022, more than 123 million annual active consumers each spent over RMB10,000 on Taobao and Tmall, representing a retention rate of approximately 98% compared to the prior twelve-month period, which was on par with the data as of the end of March. 88VIP members, our most important premium users, continued to grow at a healthy rate to 25 million by quarter end, with annual average spending of over RMB57,000 per member. Starting in July, we are seeing gradual recovery of business performance compared to June, especially in the relatively more impacted categories in the past few months such as fashion and electronics.

As we continued to grow our location-based digital commerce infrastructure in recent years, our diversified business models are showing complementary benefits. For example, while certain discretionary categories on Taobao and Tmall were negatively impacted by the pandemic, our Freshippo and Ele.me businesses captured growth opportunities in food and grocery, fulfilling family needs for daily necessities. In the past quarter, Freshippo's GMV grew over 30% year-over-year and Ele.me's GMV of non-restaurant deliveries increased by over 50% year-over-year.

We are aware that the overall growth of Taobao and Tmall's GMV was below China's retail sales growth in the past quarter, as we experienced increasingly fierce competition among various formats of e-commerce. From Alibaba's perspective, I want to be clear about our competitive strategy: On the consumer side, we will continue to strengthen Taobao app's consumer mindshare as the main shopping destination, with diversified experience of digital commerce formats. In a highly uncertain market environment, we will focus on serving the consumer groups with higher spending power, while providing a matrix of consumer offerings with diversified value propositions for different user segments, such as Taobao Deals, Taocaicai, Idle Fish, Freshippo, etc. On the merchant side, we will continue to enhance our tools and services to strengthen our marketplaces' position as the main platform for sustainable business operations. In addition, we will also take advantage of our quality of operations in China commerce: Our current scale is much bigger than our peers', and more importantly, our advantage in profitability is even larger. Therefore, we will make the best use of our capital reserves by investing in building consumer mindshare, user experience and core capabilities in key areas such as logistics and after-sales services, and execute on these as our long-term strategies.

During the COVID resurgence in major cities such as Shanghai and Beijing in April and May, the digitalized network integrating intracity commerce and fulfillment has become a new infrastructure in modern urban life. During the quarter, Ele.me's restaurant delivery volumes were negatively impacted by COVID restrictions. However, Ele.me's GMV during the quarter was less impacted as order volumes for non-restaurant deliveries such as food, grocery and medicines increased rapidly, which also contributed much higher basket size than restaurant deliveries. As COVID impacts eased, Ele.me's operation has been recovering and its GMV resumed positive growth year-over-year in June. At the same time, while Freshippo and Sun Art experienced negative impacts in offline sales during the pandemic this quarter, they played an important role in providing essential supply support for local communities leveraging their digital sales and intracity fulfillment capabilities. The percentage of online sales for Freshippo and Sun Art during the quarter reached 68% and 36%, respectively.

Ele.me’s unit economics turned positive this quarter mainly due to increased average order value as well as its ongoing focus in optimizing user acquisition spending and reducing delivery cost per order. Looking forward, Ele.me will continue to focus on its city strategy and strengthen its consumer mindset from restaurant delivery to everything delivery, while improving its operating efficiency. We are confident about narrowing Ele.me’s operating losses during this fiscal year. Amap, another important business in our local consumer services segment, continued to grow towards a destination-bound services discovery and transaction platform. In June, the number of average daily active users of Amap reached a new high of over 120 million, driven by easing COVID impacts and ongoing enrichments of local contents and services on the platform.

Our international commerce retail businesses in Southeast Asia and Europe experienced a decline due to changes in the European Union’s VAT rules, depreciation of local currencies, Russia-Ukraine conflict and normalizing offline activities after COVID restrictions lifted in the regions. In spite of these challenges, we still see great opportunities in the international market under the general trend of digitalization. Today we have already established certain foothold in the international market. On a combined basis, our international commerce retail businesses have an annualized GMV of over 50 billion US Dollars. Going forward, we will continue to focus on growing both the cross-border model and local commerce model, and building logistics as a core capability. Despite the near-term sales fluctuations, we will continue to focus on building the cross-border logistics network from China to Europe and the local logistics network in Southeast Asia. We believe the establishment of these infrastructure will bring long-term value.

Our Cloud revenues delivered 10% growth year-over-year during the quarter. The slowdown in revenue growth was a result of multiple factors, including slowing macroeconomic activities, decline in revenue from the top Internet customer, softening demand from China Internet customers and delays in parts of our hybrid cloud projects due to impacts of the COVID resurgence. Looking forward amidst the uncertainties in economic outlook and the Internet industry deceleration, our cloud business will continue to focus on the following areas: 1) building proprietary technology capabilities in key areas such as computing, big data and artificial intelligence; 2) capturing the growth opportunities in industrial internet by identifying the “sunrise industries and customers”; and 3) strengthening our cloud’s data security capabilities and defending our bottom line. We have already seen some progress in these strategies. Contribution of cloud revenue from non-Internet industries was 53% in the past quarter, up more than 5 percentage points compared to the same quarter last year. During the same period, more and more enterprise customers are adopting DingTalk to work or study as COVID-restrictions increased across the country. DingTalk will continue to strengthen its position as a digital workplace collaboration platform by further improving the capabilities and increasing user penetration of its core office products, such as document collaboration and virtual conferencing. In addition, Dingtalk will enhance its low-code application development platform, to encourage the development and usage of more diversified digital business applications on Dingtalk.

As part of our ESG strategy, we are committed to corporate governance excellence and diversity at the board level. Earlier today, we announced two new independent director appointments. Ms Irene Lee and Mr Albert Ng are both respected business leaders with invaluable global insights as well as China experience. I believe their participation will add great value to our board. In addition, Mr. Chee Hwa Tung, one of our independent directors, will not seek re-election after his current term expiring in September. I would like to express our most sincere gratitude to Mr. Tung for his invaluable contribution to Alibaba over the years.

Finally, I would like to talk about our thoughts on the path forward in the current macroenvironment. The external uncertainties, including but not limited to international geopolitical dynamics, COVID resurgence, and China’s macroeconomic policies and social trends, are beyond what we as a company can influence. The only things we can do at this moment is to focus on improving ourselves. For example, as I mentioned earlier, we have made meaningful progress during the quarter in narrowing operating losses for several business units, such as Taobao Deals, Taocaicai, Freshippo, Ele.me, Lazada and Youku, through operating efficiency enhancement and cost optimization. We are still in the process of improving the quality of operation across the organization. We are confident this is a result that we can deliver with certainty through our own efforts in a highly uncertain environment. Despite the challenges we are facing, our overall financial position remains healthy with strong free cash flow and net cash reserves, which is our biggest advantage. During uncertain times, we believe the best investment is to invest in ourselves, to build our core capabilities and to continue self-improvement. We will continue to focus on serving our high-quality consumers, building high-quality infrastructure for digital commerce and driving high-quality technology innovations. We believe these will lay the foundation for our healthy and sustainable development over the long term.

Thank you everyone for your time. I will now turn the mic over to Toby, who will walk you through the details of our financial results.

Financial Highlights

Toby Xu

CFO, Alibaba Group

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

This quarter, our total revenue was RMB206 billion, stable year-over-year. China commerce segment revenue slightly declined by 1% year-over-year to RMB142 billion, while Cloud segment revenue grew by 10% year-over-year to RMB18 billon. Income from operations for the quarter was RMB24.9 billion, a decrease of 19% year-over-year, primarily due to decreases in Adjusted EBITA. Adjusted EBITA decreased by RMB7.3 billion to RMB34.4 billion. The decrease was primarily due to RMB7.2 billion decrease in China Commerce segment EBITA, partly offset by loss reduction of RMB1.7 billion, or 36%, in Local consumer services segment.

Now let's look at cost trends for the quarter, excluding SBC, as a percentage of revenue. Cost of revenue ratio increased to 62% in June quarter, primarily due to firstly higher proportion of our direct sales business, such as Freshippo and Tmall supermarket as well as growth in Alibaba Health direct sales businesses, that resulted in increased cost of inventory as a percentage of revenue; and secondly growth of Cainiao businesses which led to increase in logistic costs as a percentage of revenue, which is partly offset by the reduction in delivery cost per order of Ele.me.

Product development expenses ratio remained stable at 5% in June quarter compared to the same quarter last year. Sales and marketing expenses ratio decreased to 12% in June quarter, reflecting our efforts in optimizing user acquisition and retention spending across businesses. General and administrative expenses ratio increased slightly to 4% in June quarter.

Non-GAAP net income was RMB30.3 billion, a decline of RMB13.2 billion year-over-year, mainly due to decrease in adjusted EBITA and share of results of equity method investees.

GAAP net income was RMB20.3 billion, a decline of RMB22.5 billion year-over-year, mainly due to decline in Non-GAAP net income and decrease in net gains arising from change in market prices of our equity investments in publicly-traded companies.

Cash flow and balance sheet: as of June 30th, 2022, we continue to maintain a strong net cash position of RMB340 billion or US$51 billion. Our strong net cash position is supported by robust cash flow generation. In June quarter 2022, Net cash from operation and free cash flow were RMB34 billion and RMB22 billion, respectively. Majority of the difference is operating CAPEX spending at RMB11 billion, reflecting our investment in Cloud business and logistics fulfillment infrastructure.

During the quarter, we repurchased approximately 38.6 million of our ADSs for approximately US$3.5 billion under our share repurchase program.

Now let's look at our segment results.

Revenue from China commerce segment in June quarter was RMB142 billion, a decrease of 1% year-over-year. Customer management revenue decreased by 10% year-over-year to RMB72 billion. Taobao and Tmall physical goods paid GMV[2] declined by mid-single-digit[3]. CMR growth lagged GMV growth this quarter, mainly due to higher order cancellations as a result of logistics bottleneck from COVID-19 resurgence and restrictions that resulted in supply chain and logistics disruptions in April and most of May. In late May, as logistics capacity normalized, we saw recovering GMV driven by a successful 6.18 Shopping Festival that was strongly supported by merchants and loyal consumers.

If we further breakdown Customer Management Revenue growth into advertising and commission revenue: Commission revenue recorded mid-teens decline due to higher order cancellations. Total advertising revenue declined slightly faster than that of paid GMV decline.

Direct sales and others revenue grew 8% to RMB65 billion, primarily driven by strong growth of online purchases of food, grocery and FMCG goods that benefitted Freshippo, Tmall Supermarket and Sun Art, partly offset by softening offline sales due to COVID-19 impacts. The percentage of online sales of Freshippo and Sun Art reached 68% and 36%, respectively, during the quarter. By leveraging our multiple direct sales businesses and on-demand delivery infrastructure, we believe we are well positioned to better serve consumers' increasing demand for on-demand delivery of food, grocery and daily necessities in the future.

China Commerce Segment Adjusted EBITA decreased by RMB7.2 billion to RMB 43.6 billion in the quarter, which is mainly due to RMB8 billion decline in CMR revenue. We are making progress to improve efficiency of loss-making businesses. The combined losses of Taobao Deals and Freshippo narrowed by RMB1.5 billion year-over-year. Taocaicai losses increased moderately year-over-year and still delivered robust GMV growth of more than 200% year-over-year. Its losses reduced significantly quarter-over-quarter driven by optimized pricing strategy, better sourcing capability and lowered operating costs.

Our International commerce segment revenue in June quarter was RMB15.5 billion, an increase of 2% year-over-year. Revenue from International commerce retail business declined by 3% to RMB10.5 billion reflecting declining revenue of AliExpress and Trendyol, offset by positive revenue growth of Lazada. Revenue from our Alibaba.com wholesale business grew 12% to RMB4.9 billion. The increase was primarily due to healthy 16% growth in value of transactions completed on Alibaba.com that lead to an increase in revenue generated by cross-border related value-added services.

Lazada delivered healthy positive revenue growth as a result of GMV growth and active increase in monetarization initiatives that resulted in higher monetarization rate. Trendyol revenue slightly declined due to ongoing depreciation of lira despite robust order growth of 46% year-over-year. AliExpress experienced declining orders due to change in the EU's VAT rules,

[2] "Physical goods paid GMV" refers to "online physical goods paid GMV."

[3] "Declined by mid-single-digit" refers to "declined by mid-single-digit year over year."

depreciation of Euro against U.S dollar as well as ongoing supply chain and logistics disruptions due to the Russia-Ukraine conflict.

International Commerce Segment Adjusted EBITA loss widened by RMB537 million to RMB1.6 billion in June quarter. This was primarily due to increased investment in Trendyol as they invest and expand into local consumer services and international B2C businesses, partly offset by reduced losses of Lazada as a result of revenue growth and enhanced operating efficiency.

Revenue for local consumer services segment grew 5% to RMB10.6 billion primarily due to more efficient use of subsidies that were contra revenue of Ele.me. Local Consumer Services Adjusted EBITA loss reduced by RMB1.7 billion year-over-year to RMB3.0 billion, primarily due to narrowed losses of our "To-home" businesses. Ele.me's unit economics per order turned positive for the quarter, driven by increased average order value year-over-year, as well as its ongoing focus on optimizing user acquisition spending and reducing delivery cost per order.

Revenue from Cainiao, after inter-segment elimination, was RMB12.1 billion in June quarter, an increase of 5% year-over-year, primarily contributed by increase in revenue from consumer logistics services as a result of service upgrade to enhance consumer experience, partly offset by the decrease in international orders from AliExpress. In June quarter, 70% of Cainiao's total revenue was generated from external customers.

Cainiao Adjusted EBITA losses were RMB185 million, up by RMB39 million. The increase was primarily due to our investment in expanding the global smart logistics infrastructure, as well as reduced profit of AliExpress fulfilments.

We will continue our efforts in building comprehensive logistic and fulfilment infrastructure in China and internationally, laying the foundation for sustainable long-term growth for our digital commerce businesses.

Revenue from our Cloud segment, after inter-segment elimination, was RMB18 billion in June quarter, an increase of 10% year-over-year. Year-over-year revenue growth of our Cloud segment reflected recovering growth of overall non-Internet industries, driven by financial services, public services, and telecommunication industries; partly offset by decline in revenue from the top Internet customer and online education customers as well as softening demand from other customers in the China's Internet industry.

For the quarter ended June 30, 2022, contribution of Cloud revenue after inter-segment elimination from non-Internet industries was 53%, up by more than 5 percentage points compared to the same quarter last year.

Adjusted EBITA of Cloud segment, which comprised of Alibaba Cloud and DingTalk, was a profit of RMB247 million in June quarter, decreased by RMB93 million year-over-year. This is primarily due to our investments in technology and increase in colocation and bandwidth cost as a result of increased usage of DingTalk's products and services from enterprises, schools and organizations due to greater hybrid-work adoption driven by COVID-19 resurgence since March 2022 in China.

Revenue from our Digital media and entertainment segment in June quarter was RMB7.2 billion, a decrease of 10% year-over-year, primarily due to decrease in revenues from Alibaba Pictures, Youku and other entertainment businesses. Adjusted EBITA was a loss of RMB630 million, up by 211 million Year-over-year. Youku continued to narrow losses year-over-year, but was offset by increased losses of other entertainment businesses due to COVID impact.

Let me wrap up with some final thoughts. Last quarter, we've shared with you some of our key operating principles and financial objectives that include:

- Focus on high-quality growth
- Improve operating efficiency and optimize cost structure
- Maintain strong cash flow and net cash position

During the quarter, we have made progress in executing these objectives. We saw losses narrowed year-over-year for a number of our businesses. We generated US$3.3 billion in free cash flow and currently has about US$50.8 billion in net cash position, which gives us the financial flexibility to grow the business and improve returns for shareholders.

Even though we are seeing a gradual demand recovery for our China Consumption businesses in the month of July. We believe there are still a lot of risks and uncertainties from slowing macro activities.

Facing these challenges, we will focus on delivering high-quality growth of our three core strategies in this highly uncertain environment, as Daniel mentioned previously. Additionally, we will continue to focus on improving operating efficiency, optimizing costs and invest in building long-term capabilities for our major businesses.

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 Chinese translation, bilingual transcripts of this call will be available on our website within one week after the meeting.

Ronald Keung (Goldman Sachs):

(Translation)

Daniel indicated that there were signs of recovery in June. I'm wondering if you could tell us more about the recovery you're seeing in terms of GMV and CMR, and what the outlook looks like for the coming half year? What are your views on consumption growth in the medium to long term, and on the e-commerce landscape?

Daniel Zhang:

(Translation)

In terms of recent consumption trends, on our platforms we've seen recovery starting from June, following that April-May period. Infrastructure capabilities have now been restored, with the recovery of supply chains and normalization of logistics. This year's 6.18 Shopping Festival saw very good performance, achieving positive growth year-on-year. The recovery continued through July, and performance in July will definitely be even better than June.

Another important factor in the recovery process is consumer psychology and consumers' expectations for the future. We can look at publicly available data, of course we look at GDP growth and nationwide retail sales, but one data point that we pay particular attention to, is consumer spending as a proportion of disposable income. According to the National Bureau of Statistics, consumer spending as a percentage of disposable income was 64% in the first half of the year, as compared against 69% in the previous year, 2021. So there has been a significant drop there, and even more so in the urban areas than in rural areas. And I think that's an entirely normal reaction on the part of consumers, in terms of consumer sentiment, in the context of the pandemic and its impact on the economy. So, certainly, although we are seeing signs of gradual recovery in consumption, I think it will take more time for that to fully play out and for consumer confidence and sentiment to fully recover.

In terms of merchants, certainly, what we've seen in our China retail marketplaces is strong willingness to take full advantage of our marketplaces to drive their business growth. That's always been the case, including through difficult times. So we see strong enthusiasm on the part of merchants to drive their sales and win over consumers --- as strong as ever or even stronger. All merchants have their own challenges, especially during this recent period, and they are keen to leverage our digital platforms to achieve better results. Thank you.

Thomas Chong (Jefferies):

(Original)

Thanks, management, for taking my questions. I have two questions. The first question is about the EBITA, we have seen EBITA improvement is much better than market expectations. Just wonder how should we think about the China commerce EBITA as well as overall EBITA in terms of when we should expect it to turn, which is the inflection point, positive year-on-year growth in coming quarters. And on the other hand, we're also noticing that the 1P business is also doing very well as well, just want to ask about our thoughts about the strategies ahead, as well as the revenue contribution and margin profile in the long run. Thank you.

Toby Xu:

(Translation)

Thank you. I will take the first part of the question relating to cost control. As you will recall, during last quarter's earning call, we stated that we would be prioritising cost structure optimisation and cost control. On this front, we've defined and implemented a whole range of different strategies across our different businesses, and I think certainly what you're seeing this quarter is that this overall cost optimization strategy has been achieving good results.

In the coming quarters, through the remainder of this fiscal year, we will continue to implement our cost control plan, focusing on cost structure optimization and on driving higher efficiencies. Of course, the key to all of this is execution. In the coming several quarters, we will continue to execute resolutely on these cost control policies.

As Daniel mentioned, and as I also mentioned in my script, we're in a financial position that allows us to have considerable flexibility. So we will be seeking a balance between cost optimisation and control on the one hand, while also continuing to make important investments in fundamental capabilities on the other, to better position ourselves for sustainable and long-term growth.

The other part of your question had to do with our EBITA margin. Certainly, as we continue to optimise our cost structure and drive further efficiencies, the improvements will be reflected in our EBITA margin. We fully expect that our pursuit of high-quality growth and high-efficiency growth will result in a higher EBITA margin.

Daniel Zhang:

(Translation)

Before I take the other part of the question about the 1P model, I'd like to add a few more comments regarding cost optimization and margins. What I'd like to highlight is that for Alibaba, our cost optimization strategy is not driven primarily by financial considerations. Rather, it's a strategic choice we've made based on our judgment of the macroenvironment and the strategic trade-offs.

As I said in my prepared remarks, both last quarter and this quarter, it is Alibaba's consistent strategy to pursue high-quality development. That means focusing on serving high-quality users. It means building high-quality digital infrastructure for commerce, and continuing to invest in high-quality technology innovation. This allows us to grow our business and achieve more sustainable and more robust financial results. We remain firmly committed to this approach.

Starting from this fiscal year, from the first quarter, as I said in my prepared remarks, we are shifting our focus in relation to consumers. In view of the changes in the macroenvironment and given that last year we reached the important milestone of 1 billion AACs, we are shifting our focus from growing our user base through new user acquisition, to better serving our existing user base of 1 billion AACs in China. This user base already covers essentially all of the active consumers in China. So going forward, we'll focus on better serving these consumers with enhanced segmentation and engagement, so as to continually grow our share of wallet with all tiers of the consumers that we have. And this shift in focus will, we believe, be highly conducive to achieving higher efficiency and improved margins.

Thomas, you also asked about the improvement that we've achieved in the performance of our core commerce segment. Simply put, this is attributable to our ability to segment and serve our consumers more effectively, thanks to the investments we've made over the past two years to build a differentiated matrix of offerings. The different pieces of this matrix provide differentiated value to different cohorts of consumers. So the investments that we've made over the past couple of years in that matrix are paying off and have put us in a solid position to continue to grow our share of wallet with all of those tiers of consumers and further improve our financial performance.

And this, of course, is also highly relevant to your other question. In our core commerce segment, when it comes to the 1P model vs. the 3P model, the choice really comes down to whichever model is best able to satisfy our consumers. That's the operating philosophy we are applying.

However, in developing our 1P strategy, we have defined a brand new 1P model. We don't want to become an online e-tailer that erects a barrier between our brand partners on the one hand and consumers on the other. Very much to the contrary, within our 1P model, although we're buying from brands and selling to consumers, we're giving the brands the same ability to engage their consumers that they would have under a 3P model. The brands have access to the same data and the same consumer insights. At the same time, the 1P model allows them to achieve higher levels of inventory efficiency and to enhance supply chain efficiency and the logistics service experience.

And certainly we will not take advantage of the 1P retail model to engage in wholesaling, merely to achieve scale. That is not something that we would do.

Alex Yao (JP Morgan):

(Translation)

Thank you. I have some follow-up questions regarding the efforts the group is making to optimize costs and drive efficiency. First, I'd like to hear more from Daniel about the underlying business logic. You talked about how the Alibaba Group overall has now entered a new stage in its development, having concluded the user growth phase and now beginning what is essentially a user engagement phase in which you will work to better segment consumers and drive growth of wallet share. But in terms of different business lines, might there be different approaches? For example, are there sectors where the pace of digitalization has been slower than you originally expected, or where there may be some adjustments to your strategic direction?

Secondly, could you tell us in more specific terms about the key cost control and efficiency enhancement measures that have been implemented this quarter, and your plans for the next few quarters? Also, in relation to the early-stage businesses --- the newer businesses that are still loss-making, how are you balancing the need to control cost and drive efficiency on the one hand against the need to invest for long-term growth on the other?

Daniel Zhang:

(Translation)

Thank you. That's a very good question. I spoke on this a bit earlier and will elaborate further here in response to your question, Alex.

In terms of our strategy, as I said earlier, today we have in place a complete matrix of consumer apps. This includes our flagship app, Taobao, which has the richest and most complete assortment of offerings; Taobao Deals, which serves consumers who are more price sensitive; as well as Taocaicai, which we launched in a period where community group buying became very hot, but with a high level of restraint. The matrix also includes Freshippo and Idle Fish. Each of these constituent pieces has a clearly differentiated value proposition.

Our ability to achieve rapid progress with cost optimization and efficiency enhancement this quarter is underpinned by the strong consumer mindshare we enjoy. That is the underlying logic. Consumer mindshare is the most valuable asset that Alibaba has built up over the years. It means that we don't need to spend money to attract consumers; they come back of their own accord. We have the ability to generate organic traffic, even in a year where consumption willingness is weaker than previous years. Organic traffic means that consumers are coming to visit and browse, with consumption intent.

As I mentioned earlier, even during the difficult period this quarter, our DAU figures and page views remained relatively stable. That shows that the consumers are with us. Consumers come back to find consumption-relevant information. So this really is our greatest asset. And our China commerce segment is well positioned to capitalize on it, having grown our user base to 1 billion AACs and having developed a robust matrix of apps that provide differentiated value to different groups of users.

The above was mainly relevant to what we call the "wide area network", i.e. our nationwide platforms. In terms of our "local area networks", i.e. our location-based marketplaces and service platforms, we have adopted a more city-focused, or region-focused, strategy across Taocaicai, Freshippo, and Eleme. For these businesses, the key is to achieve economies of scale in each "local area network", in each of the places where we choose to do business, so as to drive down unit costs.

Based on several years' experience pioneering in this space, we have developed a saying that we can share with the analyst community: for these "LAN" businesses, it's not meaningful to look at their total business size in the market as a whole. Rather, you have to look at whether they have achieved economies of scale in each individual region, each individual city, where they operate. The total market figures speak only to scale; operating efficiency needs to be looked at city-by-city and region-by-region. Only by looking at these businesses that way can you develop a truly three-dimensional perspective.

In line with that approach, we are strategically selecting and prioritizing different cities and regions in which to allocate resources to grow these businesses. And as you can see, this strategy has delivered good results this quarter.

Of course, in the current macro environment, our efficiency improvement and cost optimization strategy is not a purely financial matter. We will continue to make investments where needed and justified. We will continue to strengthen the parts of our consumer matrix that need strengthening. And we will continue to invest to strengthen our underlying capabilities, our customer service capabilities, and to improve the logistics experience. Only by doing so can we create better long-term value. Thank you.

John Choi (Daiwa):

(Original)

Thank you for taking my question. My questions are on cloud. You know, I think, from Daniel, you mentioned in the prepared remarks on the recent quarter that growth has slowed down over 2Q but as we see, you know, economy picking up a bit since 2Q as you spoken on July, we – like how should we think about the cloud revenue growth momentum towards the second half of the year? And on top of that, you know, I think, Daniel did mention previously that SaaS and elements like Dingtalk, I think, potential monetization opportunities, you know, where are we right now on these initiatives and are you seeing the macro uncertainties, kind of, pushing back, you know, deployment or initiatives and if so, how will that impact our strategy going forward? Thank you.

Rob Lin:

(Original)

John, your first part of the question was broken up. Can you just quickly summarise what you were asking?

John Choi (Daiwa):

(Original)

Okay. My question was basically on the cloud revenue growth opportunity in the second half.

Daniel Zhang:

(Original)

Let me answer this question. I think, we still need to look at the macro landscape. If you look at IT expenditure as a percentage of total GDP, I think China is far below like US and other developed or some developed countries. So, I think that's the biggest landscape.

And the second biggest thing is, as I said, actually, industrial digitalization is a trend and all the companies, all the sectors across industries, across sectors, need to be digitalized. So, I think, that's the second very important thing. So, I think, in this regard, if you look at the big picture, this is, I think, is not a cyclical opportunity. It's like a structural opportunity, I mean, for the long-term. And so that's why I think in China and in the global market, we position Cloud as one of the core strategies.

Well, the next point I want to make is that if we look at the market opportunities, actually, if we revisit the fast growth of the cloud business in the previous years, I think, one of the very important drivers was the Internet companies, because these companies are digital-savvy and they own, they have big data and they will make full usage of the big data and they need the computing power. So, I think that this has also given our Alibaba cloud a very huge opportunity to transform cloud computing from a technology to a real business, and now we are very happy that we are in the leading position in this sector.

Well, I think, going forward, especially in China with the slowdown of the internet sector, and many people talk about what's the next generation after this consumer internet. Actually, the consensus is very straightforward. It's industrial digitalization. So, I think, now we are coming to an era every company become an Internet company. Actually, not internet, it's a digital company. So, I think, so that's why, internally, we highlight the revenue contribution from non-Internet companies and we're happy to see the percentage point is increased: as we disclosed this quarter, we improved by 5 percentage points as compared to the same for the last year. So, I think, going forward, we will try to capture the opportunity in vertical industries and, of course, via our continuous investment and the innovation in proprietary technology.

Daniel Zhang:

(Translation)

Of course, it's also important to recognize that cloud business growth is connected to overall economic growth as well. Each company is a "microcell" in the economy, so when the economy is growing, they will be more willing to invest in digitalization, and will have fewer reservations about doing so. So the macroenvironment and overall economic growth prospects are of course relevant as well.

Having said that, we are paying particular attention to sunrise industries, as I said in my prepared remarks. We are positioning ourselves to seize these emerging opportunities, because there will always be some sectors and some companies that can outperform the economy as a whole, and we intend to capitalize on those opportunities.

Yang Bai (CICC):

(Translation)

My question has to do with the changes that we've seen in user behaviour over the past few years, and that have been felt keenly by all Internet companies outside the short-form video space. I’m referring to the fact that more users are spending more time consuming short-form video. What impact is this having on e-commerce? Do you expect to continue to see fast growth in short-form video, or has this development already levelled out? And from the perspective of the company, or even going beyond the perspective of the company, given these changes in consumer and merchant behavior, what strategic changes will Alibaba proactively make and what kinds of changes will Alibaba not make? Thank you.

Daniel Zhang:

(Translation)

I will take this question. Let me begin by clarifying this concept to avoid any confusion: short-form video is a content format that can convey information about a product, whereas e-commerce is an industry. Today’s e-commerce companies are making use of short-form video. Short-form video as a technology is nothing new at this point.

In fact, on Alibaba’s mobile Taobao app today, more than one half of products are now being displayed to consumers via short-form video. Five years ago, that would have all been images and text, but today, more than half of all products are being presented in the short-form video format.

So I don’t think that your question is really about the relationship between short-form video and e-commerce. Rather, it’s about the relationship between entertainment and e-commerce. And as I said earlier, the most valuable asset that Alibaba has today, that we’ve built up over the years, is user mindshare. When you want to buy something, you come to us.

Of course, we often say that shopping is a kind of entertainment. So to that extent, Alibaba also provides entertainment, but we specialize in one subcategory of entertainment, namely shopping. This category is big enough, requires a lot of know-how, and has been our consistent focus.

Along the way, we have never stopped adopting and embracing new technologies. Over the years, we’ve successively gone mobile, introduced personalization, adopted livestreaming, and adopted short-form video. For us, it’s all about making the best use of these products and technologies to provide the best user experience. And I'm certain that short-form video is not the last technology that will come along; the next big thing is just around the corner and is bound, once again, to change the consumer’s shopping experience --- just as it will change the consumer’s entertainment experience in non-shopping contexts. But any platform ultimately needs to have a clear value proposition. You need to be clear about what user demands you are serving, what is the “entrée” and what is the “dessert”.

Alicia Yap (Citigroup):

(Translation)

Good evening, management, and thanks for the opportunity to ask the last question. I'd like to ask Daniel, what at this stage is the biggest obstacle or challenge faced by Alibaba? What is your strategy for talent retention? And also what potential new areas of investment is Alibaba interested in, for example, new energy? Thank you.

Daniel Zhang:

(Translation)

You asked about the biggest challenge faced by Alibaba. Alibaba, like any other company anywhere, is a "micro cell" in the social organism. Alibaba is where it is today because of China's rapid development. China's economic growth has provided the opportunities that have allowed us to succeed over the years. Going forward, we very much hope that China's economy and society will continue to prosper. The bigger the pond, the bigger the fish can grow. Consumption sentiment will thus grow stronger, and we will be in a better position to serve people's aspirations for a better life. A favorable macroenvironment supports the survival and growth of all companies.

As a "micro cell" in the social organism, Alibaba practices, and aims to take on more, social responsibility. We seek to contribute by creating jobs, empowering SMEs, and better marrying technology with commerce. We've always done this, and we will continue to do so.

You also asked about talent. Talent is the foundation we rely on to serve our customers. All of our know-how and technology comes from our most precious asset, our talent. So we remain committed, as always, to attracting and investing in talent.

And on that note, I can share with you now that we're in August, it's the time of year when university graduates have just left college and are looking for jobs. And despite all of the macro uncertainties that we see out there, including the impact of COVID-19, we've hired close to 6,000 fresh university graduates. Most of them have already reported to work at Alibaba.

On the one hand, we're contributing to society by hiring these young graduates. On the other hand, of course, Alibaba needs these fresh talents. We need fresh blood to stimulate the "metabolism" of our company, which is a young Internet company but one with a long history, and which constantly requires new talent to move forward and innovate.

And then Alicia, the other part of your question had to do with new investment opportunities in new emerging growth areas. The fact is that there will always be an endless stream of new technologies and new industry opportunities. But as a company, Alibaba needs to look at those opportunities through the lens of our core strategy.

You mentioned new energy and that is, of course, a huge opportunity. So taking new energy as an example, Alibaba is looking at opportunities there primarily in the context of our cloud business. That's because sunrise industries like this one can start from a higher starting point, with a fully digitalized value chain from day one. Cloud computing can play a huge role there. Likewise, we also look at opportunities like autonomous vehicles and the metaverse through the lens of our core strategy. Autonomous vehicles are relevant to our logistics business, and the metaverse is relevant to the consumer experience. New energy, which you mentioned, is relevant to our cloud computing business. So that's the lens we apply to looking at these new opportunities and to finding ways to grow alongside these new emerging industries.

The other important piece, of course, is globalization. I've often talked about our three core strategies of consumption, cloud, and globalization in terms of “two verticals” and “one horizontal.” The “two verticals” are consumption and cloud, where there are lots of new opportunities. But another opportunity for us is the “horizontal” opportunity to grow our business in international markets outside of China. Part of that is about exporting our successful experience and know-how from China; and part of that is about identifying new opportunities in overseas markets. But again, we seek to capture these overseas opportunities in our strategic focal areas of consumption and cloud computing.

Rob Lin:

(Original)

Okay. I want to thank you, everyone, for joining our conference call today. If you have any questions, please feel free to reach out to the Alibaba IR team. Thank you.

[END OF TRANSCRIPT]