



Transcript of the December Quarter 2019 Results Announcement Call

Thursday, 13th February 2020

Welcome and Safe Harbor Statement

Robert Lin

Head of Investor Relations, Alibaba Group

(Original)

Good day everyone and welcome to Alibaba Group's December Quarter 2019 Results Conference Call. With us today are Daniel Zhang, Executive Chairman and CEO; Joe Tsai, Executive Vice Chairman; Maggie Wu, Chief Financial Officer. This call is also being webcast from our IR section of the corporate website. A replay of the call will be available on the website later today.

Now, let me quickly cover the safe harbor. Today's discussion will contain forward-looking statements. These forward-looking statements involve inherent risk 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 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 use on this call, such as adjusted EBITDA, adjusted EBITDA margin, adjusted EBITA, adjusted EBITA margin, marketplace-based core commerce adjusted EBITA, 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 reconciliation of GAAP to non-GAAP measures can be found in our earnings press release. Unless otherwise stated, growth rate of all of the stated metrics mentioned during this call refers to year-over-year growth versus the same quarter last year.

In addition, I want to let everyone know that today's Q&A session will be conducted in both Chinese and 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 asked. Please note that the translation is for convenience purpose only. In the case of any discrepancy, our management's statement in the original language will prevail.

With that, I am going to pass to Daniel.

December Quarter 2019 Results

Daniel Zhang

Executive Chairman and CEO, Alibaba Group

(Original)

Thank you Rob. Hello everyone. Thank you for joining our earnings call today. We delivered an outstanding quarter for a strong finish to the 2019 calendar year and have celebrated three major milestones especially important to Alibaba. First, we successfully held our 11th 11.11 Global Shopping Festival. Second, we successfully listed on the Hong Kong Stock Exchange. Thirdly, Dr. WANG Jian, Chairman of the Alibaba Technology Steering Committee¹, was the first ever representative from the private sector to be appointed as a member of the Chinese Academy of Engineering.

However, like all the other companies in China, we are confronted with a Black Swan event soon after the start of 2020: the novel coronavirus. The outbreak is having significant impact on China's economy and may, potentially, affecting the global economy. It will present near-term challenges to the development of Alibaba's business across the board. At the same time, we will see opportunities created by the forces of change. Before further elaborating I will share an overview of our performance for the December quarter.

According to the China Ministry of Commerce, total retail sales across China increased by 8% year-over-year in 2019, for a total of RMB41 trillion. Consumption contributed 58% of China's economic growth and accounted for 3.5 percentage points of China GDP growth. Online retail sales of physical goods for the year was RMB8.5 trillion, up 19.5% year-over-year. From these figures, it is clear that consumption has become the major driver of economic growth in China and online retail is the engine driving consumption growth.

Over the past quarter, our China retail marketplaces continued to maintain rapid growth in both GMV and user base. As of December 31, Annual Active Consumers reached 711 million, representing a net increase of 18 million over the previous quarter. Over 60% of new AAC came from less-developed areas. China retail marketplaces MAU reached 824 million, up 39 million from the previous quarter. We noticed stronger user engagement and buying frequency, as measured by DAU growing faster than MAU. This reflects healthy user stickiness on Taobao. Tmall online physical goods paid GMV² grew 24%, year-over-year, further consolidating our leadership position as the top consumer engagement and distribution platform for brands in China.

¹ When Dr. WANG Jian was appointed as a member of the Chinese Academy of Engineering, he was the Chairman of the Alibaba Technology Steering Committee.

² "Tmall online physical goods paid GMV" was mistakenly stated as "Tmall physical goods GMV" on the call.

Our 11th 11.11 Global Shopping Festival set a new GMV record of RMB268.4 billion. This is equivalent to 2.3 times the combined online sales of Black Friday and Cyber Monday in the US. It reflects the strength of Alibaba's digital economy and of Chinese consumers' robust consumption power. More and more merchants are leveraging 11.11 to acquire new customers, launch new products and develop new categories. During this year's 11.11, 15 brands surpassed RMB1 billion in their total sales; 215 premium brands launched their new products and new categories; and 120,000 merchants each acquired over 10,000 new customers.

Our globalization strategy enjoyed solid progress this quarter. Lazada and AliExpress continued to grow rapidly as a result of effective strategies in user acquisition and merchant onboarding. Lazada quarterly orders increased 97% year-over-year and AliExpress' DAU grew by 56% for the month of December. Tmall Global paid GMV grew by 45% year-on-year and it continued to consolidate its leading position in China's cross-border import market. And with the ongoing optimization of bonded warehouse import logistics solutions, Tmall Global's end-to-end order delivery time has further improved, to 2.78 days³, which is a 10% reduction in delivery time compared to the same period last year.

Cainiao Network continued to go from strength to strength. During this 11.11, Cainiao processed a record-breaking 1.29 billion number of packages. Of those, 960 million⁴ packages were delivered within one week, an improvement of 30% year-over-year, as a result of ongoing platform optimization and the collective efforts with our logistics partners. We also saw a preference for using Cainiao Post, our last-mile service stations in residential areas and campuses. The number of packages collected via Cainiao Post increased by 88% year-over-year. In November 2019, we invested RMB23.3 billion to raise our equity stake in Cainiao from 51% to 63%⁵. This investment is a demonstration of Alibaba's commitment to the development of a smart logistics platform as one of the core pieces of infrastructure for digital commerce.

Alibaba Cloud continued its rapid rise, with 62% year-over-year revenue growth. We celebrated two meaningful milestones this quarter. The first milestone is Alibaba Cloud revenue surpassed RMB10 billion in a single quarter for the first time. The second milestone was the successful migration of our ecommerce business core systems onto the public cloud. During 11.11, our public cloud infrastructure and technology helped us to power the creation of over 544,000 orders per second at peak, process 970 petabytes of data without any disruption and defend against 6 billion cyberattacks, all within the 24-hour period. We believe the migration of Alibaba's core ecommerce systems to the public cloud is a watershed event. Not only will we, ourselves, enjoy greater operating efficiency but we believe it will also encourage others to adopt our public cloud infrastructure.

Now I would like to speak to the coronavirus situation on three areas. First, the responsibilities and the duties that we assumed towards the community immediately upon the outbreak. Second, our relief measures to support SMEs. Third, the potential challenges and opportunities that we see for Alibaba's business in connection with the outbreak.

³ "to 2.78 days" was mistakenly stated as "by 2.78 days" on the call.

⁴ "960 million" was mistakenly stated as "690 million" on the call.

⁵ "63%" was mistakenly stated as "53%" on the call.

Let me start with our actions related to our community. We took every effort to protect the health and safety of our employees through flexible work policy and remote office collaboration, using our proprietary technologies. At the same time, we leveraged Alibaba's powerful forces of commerce and technology to deliver supplies to the affected regions. This is our responsibility to our community.

Soon after the outbreak, we also began to procure medical supplies from around the world. To date, over 40 million units of medical supplies, worth RMB468 million, are on their way or have been donated to Wuhan and other affected cities. Cainiao teamed up with our global industry partners to launch a "fast-track" logistics channel that facilitated delivery of over 26 million units of medical supplies into Wuhan and other cities to date.

We also worked to ensure supply of food and other consumables for the residents in affected regions. Our self-operated grocery chain, Freshippo, committed to a policy of remaining open for business, no raising prices and remaining stocked, particularly in the 18 stores across Wuhan. Freshippo became a lifeline for many local residents. Additionally, Freshippo and Ele.me teamed up with restaurant chains to provide free meals and necessities to the hospital staff in Wuhan and emergency response teams.

Alibaba also contributed the power of our advanced technologies to combat the outbreak. DAMO Academy provided a free AI voice chat bot service to government and epidemic prevention agency to efficiently keep a daily health record of those who might have close contact with infected patients. Our enterprise communication and collaboration app, DingTalk, introduced a digital health check-in feature to help companies maintain up-to-date health monitoring of their employees. To-date, there have been more than 150 million daily health check-ins recorded in DingTalk.

Now, about our relief measures in support of SMEs. Together with Ant Financial, we announced a comprehensive set of relief measures that fall under six categories.

1. Reduction of business operation costs on our platforms.
2. Financial support by waiving or lowering interest rates.
3. Subsidies for delivery personnel and raising the level of logistics efficiency.
4. Provision of flexible job opportunities to guarantee income.
5. Additional tools for businesses to accelerate digitalization.
6. Remote working management for enterprises.

We will support our merchants to overcome this challenging time and are taking proactive measures to fulfil our mission to "make it easy to do business anywhere".

Lastly, the potential impact on our business. We are closely monitoring the challenges, as well as identifying opportunities, for Alibaba's business as the situation evolves.

For our ecommerce business, the delay in employees returning to work following the Spring Festival holiday is preventing merchants and the logistics companies from resuming operations. For the first two weeks after the Chinese New Year holiday, we have observed negative impact on our commerce business, as merchant operations have not returned to normal and a significant number of packages were not able to be delivered on time.

In our New Retail business, Freshippo and Taoxianda's average basket size increased significantly as a result of consumer migration through online purchasing of fresh goods, groceries and a broader selection of daily necessities. However, limitations in delivery capacity is preventing order volume from fully recovering.

For the local consumer services, restaurant visits and the food-delivery orders declined noticeably year-over-year because many restaurants have not resumed normal operations. Other categories, like grocery shopping, have increased sharply.

Our travel booking service, Fliggy, received material levels of cancellations for air tickets, hotel reservations and tour packages. In accordance with government regulations, Fliggy provided unconditional and penalty-free cancellation to our customers.

DingTalk has experienced explosive growth in DAU and the number of corporate users. It is providing business with remote working features to maintain their operation and accelerate their digitization. In addition, DingTalk also saw increasing popularity over virtual classrooms that helped schools and students resume their studies via live streaming classes.

We are closely monitoring the impact of the ongoing outbreak on our business and we will take necessary measures to ensure our business operations. Our mission is to make it easy to do business anywhere and we are being tested. True to our vision, we will stand together with all of our merchants to overcome the current challenges and will facilitate our users and our communities to fight against the virus.

17 years ago, the ecommerce business experienced tremendous growth after SARS. We believe that adversity will be followed by changes in behavior among consumers and enterprises, and bring ensuing opportunities. We have observed more and more consumers getting comfortable with taking care of their daily living needs and working requirements through digital means. We are confident in the ongoing digitalization of China's economy and society, and are ready to seize the opportunity to build the foundation for the long-term growth of Alibaba's digital economy.

Now I will turn the call over to Maggie, who will walk you through the details of our financial results.

Financial Results

Maggie Wu

Chief Financial Officer, Alibaba Group

(Original)

Thank you, Daniel. Thank you, everyone, for joining us. Before we start, I would like to say that our thoughts and prayers go to those families deeply impacted by the coronavirus outbreak. At the end of my prepared remarks, I will also share with you our current assessment of the effects of this epidemic.

Before talking about this quarter's financial results, let me give you a quick summary on the Hong Kong listing. On November 26, we successfully listed on the Hong Kong Stock Exchange. We offered 575 million new ordinary shares with proceeds of about HKD100 billion, or about US\$13 billion, so our shares are multiple times oversubscribed. We view Hong Kong as strategically important to us, so overall this is a very successful listing.

Let me review our financial highlights. We had another strong quarter. We achieved strong results for our Core Commerce segment, reflecting our strategic focus on user acquisition and engagement, as well as enhancing product varieties and increasing our offering of price-competitive products. Mobile MAUs were up 39 million, reaching 824 million and Annual Active Consumers in our China retail marketplace increased by 18 million to 711 million. Over 60% of new Annual Active Consumers were from less-developed areas. The increase in consumer growth reflected continuous improvement in our consumer segment initiatives. These initiatives have been well received by consumers, as evidenced by higher purchase frequency for our China retail marketplace business.

When we look at our December quarter revenue, our total revenue grew 38% to RMB161 billion. Excluding the effects of consolidating acquired businesses, mainly Kaola, total revenue would still have grown at 33%. The increase was mainly driven by robust growth of our China Commerce Retail business and Alibaba Cloud.

Our operation continues to run efficiently, so when you look at the quarter's cost trends, costs and expenses are well controlled while our business has continued to grow.

Let us turn to the segment reports. Core Commerce continued to be very strong. Revenue grew 38% to RMB141 billion. The fundamentals of our China retail business continued to be very strong and customer management revenue grew by 23% in the quarter. This growth was primarily the result of an increase in the average unit price per click and an increase in volume of paid clicks from improving click-through rate. The growth also reflects strong growth in the number of paying merchants during the quarter. Commission revenue grew by 16%, primarily due to strong 24% growth of Tmall online paid physical goods GMV.

When you look at the growth of revenue and GMV, there is a gap and this is primarily because of two factors. One, more merchants, particularly in those strategically important categories, received preferential commission rates. Second, the revenue mix shift within Tmall Supermarket from commission-based revenue to direct sales continued to have an impact, as we discussed in the previous quarter. As you know, in our direct sales business we do not receive commission from third-party merchants, but rather realize our economics from our product margins. The increase in direct sales volume helps us improve our supply chain and operational efficiency for the business.

China Retail Others' revenue, this is mainly our new retail business revenue, is still growing very strongly; 128%. This increase was driven by our direct sales business, including Tmall Supermarket and Freshippo (Hema). This quarter is also the first full quarter of consolidation of Kaola, which we acquired in September 2019.

Let us take a look at the details for International Retail. As Daniel mentioned, we experienced strong growth in our global markets. Lazada and AliExpress continued to deliver robust growth in orders and active merchants. Revenue from our International Retail business grew 27% to RMB7.4 billion. The increase was primarily driven by growth in revenue from Lazada, but was partially offset by slower revenue growth from AliExpress, because we deconsolidated the Russian business of AliExpress in October 2019 because we set up the JV with the local partners, as we reported in the previous quarter.

If we look at Cainiao, the fast growth cross-border businesses supported the increased adoption fulfilled by Cainiao's service. This growth contributed to strong revenue growth for Cainiao. In the quarter, Cainiao's revenue reached RMB7.5 billion, growing at 67%.

For our Local Consumer Services, revenue grew 47% to RMB7.6 billion. During the quarter, we continued to achieve strong growth in GMV, driven by robust order growth and an increase in average order value. We will continue to take a targeted and systematic approach to invest in Local Consumer Services.

Alibaba Cloud. Cloud computing revenue grew at 62%, reaching RMB10.7 billion. This is the first quarter that cloud business revenue surpassed RMB10 billion. The robust cloud revenue growth was primarily driven by increased revenue contributions from both our public cloud and hybrid cloud business.

Let us look at profitability. In our Commerce segment, we continued to generate strong market-based Core Commerce adjusted EBITA, which reached RMB66 billion, growing at 22%. Comparing to a year ago, we have increased adjusted EBITA by RMB12 billion in absolute dollar amount while the combined losses in our four strategic areas were all flat year-over-year. This reflects our targeted approach to the allocation of resources and investment in key strategic growth areas while also optimizing costs and improving efficiency. After incorporating these losses, our Core Commerce adjusted EBITA grew strongly, by 26%.

Looking at the Cloud Computing segment, adjusted EBITA was a loss of RMB356 million. The EBITA margin improved slightly during the quarter, so the loss margin narrowed.

Our Digital Media and Entertainment segment's adjusted EBITA loss was RMB3.3 billion. This loss has been significantly reduced from RMB6 billion in the same quarter last year. Excluding content impairment impact, EBITA losses would be RMB1.2 billion, a reduction from RMB3.2 billion⁶ in the same quarter last year.

Innovation Initiatives' adjusted EBITA was a loss of RMB1.9 billion.

Looking at free cash flow and expenditures, our business, overall, continued to show strong profitability and cash flow. As of December 31, 2019, cash, cash equivalents and short-term investments were RMB352 billion, or approximately US\$50 billion. For the December quarter, free cash flow was RMB78 billion, which increased by 52%. This is mainly due to our robust profitability growth as well as a decrease in CAPEX expenditure – this is a seasonal reason.

Other financial metrics. The share of profit from other equity initiatives in the quarter reached RMB2 billion, which mainly includes our share of profit from Suning under equity accounting, as Suning completed a transaction related to their financial businesses that created a one-time gain. In addition, given we received a 33% equity interest in Ant Financial on September 23, 2019, we recorded a share of profits of RMB215 million from Ant Financial for the period September 24 to September 30. As a reminder, our equity accounts for a stake in Ant Financial is on a one-quarter lag basis, as in the case for our equity investees. There was no other income arising from our prior 37.5% profit-sharing arrangement with Ant Financial during this quarter, as it was terminated in September and replaced by this equity pickup.

GAAP net income during the quarter was RMB50 billion, up 62%. To reconcile GAAP net income to non-GAAP net income, we made the following adjustments. First, the exclusion of RMB17 billion in investment gains and others. These gains primarily include a one-time gain related to our contribution to the AliExpress Russia businesses into a JV, as well as a gain in the fair value of our equity investments. Second, the exclusion of an additional RMB2.3 billion one-time gain related to the 33% equity interest in Ant that we received in September. Excluding these gains and losses and certain other items, our non-GAAP net income would have increased by 56% to RMB46.5 billion.

We have finished the cash flow discussion, so now let us take a look at the impact of the recent coronavirus outbreak.

We ended calendar 2019 on a high note. We successfully listed on the Hong Kong Stock Exchange and delivered a strong set of results in the December 2019 quarter. This strong performance continued in the month of January, with our major businesses maintaining solid revenue growth. As Daniel mentioned in his remarks, some of our major businesses have been negatively impacted in February due to the coronavirus outbreak and the resulting business disruption that followed in most parts of the economy. At the same time, we have announced, together with Ant Financial, 20 major initiatives and relief programs to help our customers and partners.

⁶ "RMB3.2 billion" was mistakenly stated as "RMB2.8 billion" on the call.

While it is too early to quantify the financial impact of the coronavirus on our business, I would like to provide some qualitative observations on the situation. First, let me talk about the macro view and how we think about what has happened recently. The epidemic has negatively impacted the overall China economy, especially the retail and service sectors. While demand for goods and services is there, the means of production in the economy has been hampered by the delayed opening of offices, factories and stores after the Lunar New Year holiday.

We, like other businesses, are not immune to this imbalance of supply and demand. However, we see this unfortunate situation as an opportunity to provide value and support to our customers in order to help them recover production and supply capability as soon as possible. Their recovery and long-term success will translate into sustainable long-term growth for Alibaba Group. This is similar to what we experienced during the SARS outbreak in 2003.

Okay, so number two, let me talk about what happened in our business. So, Daniel mentioned the operational impact of a series of disruptions to supply chain, manufacturing activities and logistics so far in February. At the same time, we are supporting our customers by waiving fees and together with Ant Financial, we are providing interest free or lower interest loans. The situation is to help normalize our merchants' operations.

Then, talk about the impact. Because we are only halfway through the March quarter and because there is still uncertain ongoing development of this coronavirus, it is really difficult for us to have an accurate estimation for the full financial impact for this March quarter. But as of today, what we have seen, particularly in the past 12-13 days, since the start of February, our overall revenue growth rate we believe will be negatively impacted for March quarter. Some of our businesses that rely on physical means of production on supply side will even show negative revenue growth for the quarter, such as China Retail Marketplace and Local Consumer Services.

Overall, we remain optimistic about consumption growth in China and continue to be confident about our long-term growth prospects. So whatever we have seen right now, we believe this is a one-off occurrence. By helping our customers through difficult times, we and they will emerge even stronger and will have greater opportunity to drive long term sustainable growth.

So, that ends my remarks. Let us go to the Q&A. Thank you.

Q&A

Thomas Chong (Jefferies):

(Original)

Hi, good evening. Thanks management for taking my questions. I have a question about the migration to online, post the coronavirus, would our digitization strategy further speed up, given offline merchants realize the significance of going online and data insights from our ecosystem.

The other question I have is about the synergies with Ant in local services. What are the strategies to further unlock the potential of Ele.me on top of food delivery? Thank you.

Daniel Zhang:

(Original)

Thank you, Thomas. This is Daniel. Let me answer these two questions. For the first one, I think in this outbreak, that many, many residents and consumers changed their way of living and for many offices, many workers, they changed their way of how to work. So, people now work remotely from home. People buy foods, buy fresh products, buy groceries, buy necessities, from home. I think the crisis is a very big challenge to the society but also, as I said in my remarks, give people a chance to try new way of living and new way of work. So, I think after all is done, I would expect that this is an inevitable trend that more and more business and more and more customers will have a digital life or digital working style. So, this obviously will, in the long-term, will be good for the digital pace of the whole society.

Okay, for the second question, I think local service is very, very important sector in consumption. You all know that Alibaba has strong commitment to this sector and we do not view this as a business but we think this is a foundation for the consumption. I think in the previous month, we are happy to have Simon Hu, the new CEO of Ant Financial, taking also a chairman role of our local service company, which gives us a good chance to realize more synergies between Alipay and the local service business. And Alipay today, starting from a payment tool, now is evolving and upgrading to a very strong consumer interface.

Eddie Leung (Bank of America):

(Original)

Good evening. I wish everyone well.

(Translation)

My question is regarding Tmall and Taobao. We heard both from Daniel and from Maggie that there is an impact on both supply and on logistics being brought about, of course, by this coronavirus outbreak. My question, however, goes to the demand side. I wonder if you are seeing any different impact on demand, for example in different categories or in different markets, for example first-tier cities versus the less developed markets. At least from a direction perspective, could you tell us about any impact you are seeing on demand side, for example in categories like clothing or white goods or others? Thank you.

Daniel Zhang:

(Translation)

Well, thank you very much for your question and also for your best wishes. The answer is yes, we certainly are seeing some relatively large changes in demand in different categories. For example, in the category including foods and daily necessities, fast-moving consumer goods, we are seeing relatively rapid growth. Of course, part of that growth is coming from the traditional retail sales sector with delivery from close-by shops.

Secondly, when you look at categories like clothing and consumer electronics, of course there is a big challenge there, including on the supply side. But also including reduced willingness on the part of consumers to make those kinds of purchases at the height of the epidemic. Of course, I am confident that that will turn around as the situation improves.

And in terms of regional differences, one new thing that we are seeing in the face of the epidemic is increased uptake by online users in the lower-tier cities or the less developed regions of China in terms of going online to purchase daily necessities. And we think in the long term that will be a favorable trend.

Thank you!

Alex Yao (JP Morgan):

(Original)

Thank you, management, for taking the question, and best wishes to working through the challenging environment. I would like to clarify with Maggie your comment about the financial implication to the quarter from the current situation. Did you say that the business with a strong connection to physical production and fulfilment will decline? Specifically, I heard you talk about China Marketplace revenue will decline for March, which means your CMR and the commission revenue will decline. So, that is the first part.

The second part is, if we assume this coronavirus situation is short-lived, just like what happened in 2003 from SARS, should we be expecting a V-shaped recovery or U-shaped recovery? Is there anything that prevents things getting back to normal immediately after the situation is gone? Thank you.

Maggie Wu:

(Original)

Okay. Maybe I will first answer Alex's question on the financial impact and then Daniel could give his view on the shapes, V or U. Okay. So, for financial impact, Alex I talked about so what could impact our financials for March quarter. There are two things. One thing is the coronavirus outbreak impact on own business. The other thing is that we are also offering these relief programs to help our merchants. Okay?

So, let me talk about overall impact. I said two things. Number one is that we estimated March quarter revenue growth would experience negative impact, which means that the growth rate will come down. It is possible that the growth rate will come down significantly. We just do not know yet, because this is just the middle of February. Number two, I said that the business in our China retail marketplace, these are pricing related, which means China retail marketplace, which means Taobao and Tmall, which means CMR and commissions, as well as the local consumer service, would likely experience negative revenue growth. So, that is to clarify.

Daniel Zhang:

(Original)

This is Daniel. Let me answer the second question. I think will it be a U correction or V-shape correction is highly dependent on how long it will take to finish this outbreak. The longer time it takes, I think it will take an even longer time to recover, because I think many service sectors are disrupted during this outbreak. I think if we can recover, as we see in recent days and we see some good indications in major cities except for Wuhan, I think that will take time to see how quickly we recover.

Binnie Wong (HSBC):

(Original)

Again, best wishes to everyone and I hope the situation will improve very soon. My question is actually on the local services. If you look at the loss tracked to the core commerce EBITDA, the line adjusted for the effects in the losses in the local services, we see it is positive to note that the loss margin percentage is actually narrowing. So, shall we expect a similar trend is going to continue? And I guess in this round of press release, company especially mentioned that where Ele.me acquired a 48% of new customers from Alipay app. So, can we expect that the competition in local services is rationalizing and then will beyond just a price competition as we have seen in the last year? That is the number-one question.

And my second question is just housekeeping. We see meaningful operating leverage in the product development expenses. I just want to understand what are the positive reasons we have seen on the improvement. Thank you.

Daniel Zhang:

(Original)

For the first question, for local services, actually, local service business is our long-term commitment and we do not manage the business purely by EBITDA ratio. We focus on creating the value for both the customers and merchants. So, I think today all the service sectors are in the process of digitalizing their business, and the consumers are really enjoying their digital lives. So, I think we will work even harder to try to identify the value for both merchants and consumers and try to create the incremental to them.

Maggie Wu:

(Original)

Binnie, let me answer your second question regarding the product development leverage. So, if you break it down, the staff cost is mainly the item that brings this leverage. Basically, the growth of this payroll is not as the same growth of the same pace of the revenue growth. We have been quite aggressively looking for the top data scientists, engineers, etc., but in terms of this quarter, what you have seen is that since the revenue grew very strong, recruiting in this quarter is actually not at the same pace. We have been recruiting throughout the past quarters, so I guess along with the business growth, some of the fixed costs would not grow. This is where the operating leverage comes from.

Tina Long (Credit Suisse):

(Translation)

Thank you, management. Just a couple of small questions. My first question relates to the information received regarding differences in commission revenue and also in GMV for different merchants in different categories, where preferential pricing was applied. And I am wondering if that is a one-off thing or the 11.11 Singles Day Shopping Festival or if that differential pricing is going to be an ongoing exercise going forward. And if you could tell us which categories are enjoying the preferential rates. That is the first question.⁷

The second question has to do with the impact of the coronavirus outbreak. Maggie has already indicated that for the coming quarter, revenue growth is likely to be negatively impacted. I am wondering what your thinking is on the cost side of things. Obviously, you have fixed costs that you cannot do much about, but when it comes to variable costs – non-essential spending, things like marketing – are you giving any consideration to throttling back there so as to try to come out with earnings that are not too badly hit?

Maggie Wu:

(Translation)

Thank you for your question. On your first question regarding commission, discounts offered in the 11.11 Shopping Festival for different categories is true as 11.11 was performed excellently this year. Those discounts are being offered to eligible merchants in key categories, including FMCG and Electronics. And these are merchants who have performed very robustly in terms of their GMV, hitting GMV targets and therefore, in line with our commission-discount policy, they are receiving a discount.

On your second question, as to what we are doing around cost and expenses in the current climate affected by the epidemic, the answer is yes, certainly, there are some areas in which we can and will achieve some cost savings, for example, by having more offline meetings and of course reducing travel. Many of our staff – management staff, frontline staff – are now working remotely from home. Daily meetings between Daniel and the various business presidents are being held again on a remote basis. It is a good learning for us as a company, as we are finding that efficiency is okay, operations and management are being well handled, even without having physical and face-to-face meetings. That certainly could be a take-away for us going forward, to do more things online and reduce physical meetings. Yes, certainly there are some savings in connection with that.

However, your subsequent⁸ question is can it help with profit growth? And my answer to that is that profit really comes down to revenue. The most important thing when it comes to profit is revenue. Our revenue is being affected in the various ways we have already described to you. Therefore, there will be some savings from the areas I have described.⁹

⁷ This sentence was not part of Tina's question.

⁸ This part was omitted from the translation on the call.

⁹ This part was omitted from the translation on the call.

The other thing to remember is we have very robust support programs that we have mentioned for merchants. Probably, these are the most robust support programs ever offered by any company in this market or around the world in the face of such difficult circumstances. That again will have a negative impact, as we said, on our profit. And there will be some savings as mentioned just now which will have a positive impact on profit.¹⁰ I think this is just as what Daniel and I mentioned, we feel that after the epidemic, what is meant to be will be, we see this as a one-off impact.¹¹ Some of the learnings and outcomes will be good and result in improved, but overall that is the situation.

Mark Mahaney (RBC Capital Markets):

(Original)

Thank you. I do wish you the best. I wanted to ask a broad question about online retail penetration. Those in China, those numbers that you mentioned at the very beginning of the call suggested perhaps 27% or a quarter of retail activity in China occurs through online channels. I would imagine that there is a big discrepancy within the country; there are some markets where that percentage is much higher, and some that is it much lower. Do you have a sense of what that range is like? Most interesting is how high of penetration rates have you seen? How high have you seen online as a percentage of total retail sales get within China? Thank you very much.

Daniel Zhang:

(Original)

This is Daniel, thanks for your wishes. To answer your question, I think for online retail penetration, we have to look at this from different angles. First, as you said, it is about the region. In top tier cities, today in China, online penetration is already quite high, but we do see a growing demand in the lower-tier cities. That is why in this quarter we observed over 60% of the new customers actually from the less-developed areas. We believe that the lower-tiered cities, even in rural areas, because of the penetration of the 4G, and going forward 5G, the infrastructure is there. Therefore, people can enjoy the same digital life as people in urban cities.

Let me share with you my thoughts on the second angle, which is the category. I think today, even in popular cities in China, online penetration by category is quite different. Before this coronavirus, what we saw was that online penetration for apparel and consumer electronics was relatively high. However, for the food category, especially for fresh food, the penetration is low, even in urban cities. As I said in my remarks, during the past month, more and more people are getting used to shopping online for food and for daily necessities. They may shop from an ecommerce website or they may shop from a mobile app operated by a store nearby. I think that shop from home and store delivery or having a hub and spoke model delivery, I think going forward will have more penetration after this outbreak.

¹⁰ This part was omitted from the translation on the call.

¹¹ This part was omitted from the translation on the call.

Alicia Yap (Citigroup):

(Translation)

Thank you, management, for the presentations and for your detailed thoughts that you shared on the impact of the current situation. A few follow-up questions if I may. My first goes to Maggie in regard to Cainiao, because I do not believe you mentioned Cainiao. Can we expect that in the March quarter the growth of Cainiao will be negatively impacted? As you said, the China retail market and other businesses will be, as a result of this outbreak. Conversely, for cloud, could we expect there to be any benefit there from the epidemic in the March quarter, or would you expect the benefit to be more of a long-term benefit?

Then secondly, I would like to follow up on the previous question regarding the preferential commission rates that are being offered for certain categories – FMCG and electronics. Were those preferential rates only for 11.11 Shopping Festival or over a longer period of time, and will they continue in the March quarter?

Finally, still on preferential commissions, in the face of this epidemic, will you consider offering preferential commissions for a broader range of categories? For example, fashion, but also other categories, and perhaps continuing those preferential rates beyond the March quarter and in the longer-term? Thank you.

Maggie Wu:

(Translation)

Thank you for the two questions. I will start the question about the impact of the coronavirus epidemic on Cainiao. You were asking whether there could be negative growth there similar to what we have talked about, expecting to see with Taobao and Tmall, and Local Consumer¹² Services. The answer is that there is a very real impact on the business of Cainiao as a result of the epidemic – less of an impact on the financial side of things. I will explain why that is.

From early February until now¹³, with many couriers not being able to return to work, capacity remains very low; it is around 10+%, less than 20% of capacity availability. But revenues are not changing that much, despite the situation. This is because we have technology products for which we are now charging fees, as well as good revenue performance from the last mile services that Cainiao was providing. This represents an increase in the revenue base for Cainiao compared to last year.

The second reason is because Cainiao is a consolidated business¹⁴, so it is subject to adjustment for inter-company elimination in terms of its services to¹⁵ Tmall, Tmall Supermarket. For these reasons, you do not expect to see such a big impact on the revenue of Cainiao as on its actual operations.

¹² This part was omitted in the translation on the call.

¹³ This part was omitted in the translation on the call.

¹⁴ “a consolidated business” was mistakenly translated as “an acquired company” in the call.

¹⁵ “services to” was mistakenly translated as “cooperation with” by the translator in the call.

Your second question had to do with the preferential commission policy. So, to clarify, this is not a new policy. It was not new this year and it was not just for the 11.11 Shopping Festival. It is there to encourage and reward good merchants with good performance who meet targets defined in the policy. So, we will continue to have this policy to reward merchants and we will certainly consider expanding into new kinds of categories.

Piyush Mubayi (Goldman Sachs):

(Original)

We sincerely hope that all the families with the Alibaba ecosystem touches are safe. I wondered, Daniel talked about, I thought, an improvement over the last 12 days. Could you just take us through qualitatively what is the degree of improvement we have seen over the 12, 13 days? And I think initially Daniel also talked about the opportunities that get created out of a period like that, and I know we talked about DingTalk and how that has seen such a transformation with more than 200 million folks working from home. What are the top three features in DingTalk that have proven to be very popular? And how do we see this product evolve in terms of size, scale, MAU/DAU for example since CNY?

Daniel Zhang:

(Original)

Thank you, Piyush, for your kind words. So, actually, things changed very fast in the past 10 to 15 days. I think before this week, most of the merchants, they do not have access back to work. But since this Monday I think in big cities in China like Shanghai, Beijing, Guangzhou, Shenzhen and more and more companies' staff, they are back to work partially. And also, we see the logistic network start to resume operation, especially in the sortation center in big cities, in big hub. So, that is why I am saying that situation are getting slightly better but it takes time to back to normal.

But I think the key thing is all about supply: the supplier of the products, the supplier of the delivery, the supplier of the services. And the demand I think is still there and I strongly believe that after the virus leaves away, I think consumers have strong desire because they have been in home for long time and they will go out anyway to consume.

So, for DingTalk, yes, I think DingTalk experience explosive growth during the outbreak. I think via DingTalk we facilitate our people to work from home and to study in the virtual class online, and, also, as said in my remarks, facilitate many companies to do the health check-in every day with their employees. And we have live video conference, live minutes, live virtual classroom are all very popular among the workers, office managers, office staffs, as well as for education sector we do see very big popularity among the teachers and students in terms of the virtual classroom.

So, we'll continue to expand our capacity. And I can share with you in the past 10 days, we keep expanding our capacity. But even with the capacity increase, we have to conquer some difficulties that is being in data center and we may be prohibited to access some data centers in some regions because of the anti-coronavirus. But I think that things are getting better after many, many people go back to work.

Robert Lin:

(Original)

Okay. Thank you everyone for joining our earnings call today. If you do have any additional questions, please feel free to contact anyone at IR team. Thank you.

[END OF TRANSCRIPT]