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China – e-Commerce | Asia Pacific

Primer

A stricter regulatory environment could mitigate the trend of involution in China's e-Commerce market – but it also prevents e-Commerce players from using their old subsidy-driven expansion strategy to find new growth drivers when overall growth is set to slow down.

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Trend of involution in China's e-Commerce market: Both e-Commerce penetration and users were boosted significantly by Covid in the past two years. The consequent market-wide growth slowdown has led to a clear trend of "involution" (*nei juan* in Chinese). This means that players strive for limited resources in an industry without meaningful incremental growth, resulting in excessive competition and diminishing marginal benefits – hence, failing to realise their maximum economic potential. With new technologies unable to bring incremental growth to the whole market, new entrants such as live streaming e-Commerce players are competing in categories that already have high online penetration, leading to fast-diminishing marginal benefits of the market overall.

Leading e-Commerce players are still using old ways to find new growth drivers: Against the backdrop of market growth slowdown, leading players are eager to find new growth drivers. However, path dependence means they are still relying on the old subsidy-driven expansion strategy, which is not only discouraged under the new regulatory environment but also further erodes the returns of their selling & marketing expenditures.

How the regulatory reset will affect China's e-Commerce market: On the positive side, a more stringent regulatory environment will mitigate the involution in the e-Commerce market to some extent, which could lead to better profitability for leading players. However, a stricter regulatory environment also makes it more difficult for e-Commerce players to find new growth drivers (leveraging the subsidy-driven expansion strategy). As such, the growth slowdown of the e-Commerce market is hard to reverse.

How to invest in China's e-Commerce market after regulatory reset: We believe the cross-market growth slowdown in e-Commerce will leave limited opportunity for e-Commerce platforms to re-rate until any player can find a meaningful new growth driver. As such, we suggest being more selective and focusing on players that have above-industry revenue and earnings growth prospects – JD and Pinduoduo.

Executive Summary

This report is structured in five sections. The intention is to delve into the developments in China's e-Commerce segment in the past three years, focusing on regulatory reset and its impact, Covid impact, competition, and our views on China's e-Commerce market in the future. Here we extract the main content from each section.

1. Recap of China's regulatory reset and where we are in the regulatory reset cycle

China's Internet industry, including the e-Commerce market, has experienced a stringent regulatory environment over the past three years, with stricter regulations on antitrust, preventing disorderly capital expansion, social security for flexible workers, and cybersecurity.

Since 2022, we have witnessed a series of events signaling that the regulatory reset has moved to a standardized and more predictable stage. Vice Premier Liu He's speech at the Financial Stability Committee meeting on March 16 marked an inflection point for the regulatory reset cycle for China's Internet companies. Boss Zhipin's resumption of new user registration on June 29 after a year-long cybersecurity investigation, and the Cybersecurity Administration of China announcing a fine of Rmb8.026bn on DiDi for its breaking of data security laws on July 21, further confirm that a stable regulatory environment for the Internet industry is coming.

2. China's e-Commerce growth was boosted by Covid – but growth potential was also overdrawn

Over the past two years, the Covid outbreak not only boosted e-Commerce penetration to 31-32% in 2020/21 but also pushed e-Commerce users to a ceiling – online shopping users were 82% of total Internet users in China as of 2021.

However, this is more short-term gain and long-term pain for the e-Commerce market, which has overdrawn its growth potential in the next few years. This has led to slower growth of the whole e-Commerce market, increasing competition, and brought forward e-Commerce platforms' schedule to look for their new growth drivers.

3. Main areas of competition in China's e-Commerce segment

We identify three main areas of competition in China's e-Commerce segment in the past few years.

- **Live streaming e-Commerce – an example of e-Commerce involution:** Live streaming shopping has emerged as a new e-Commerce format and shown rapid growth during Covid. However, we believe live streaming e-Commerce generates little incremental online TAM given its focused categories already have high e-Commerce penetration (such as apparel and cosmetics), leading to excessive competition with limited resources and thus involution.

- **Lower-tier cities – an example of e-Commerce involution:** Pinduoduo has effectively made the market pie bigger by bringing new online TAM from lower-tier cities. Alibaba's launch of Taobao Deals and JD's Jingxi will likely only lead to involution because e-Commerce penetration in lower-tier cities has reached a high level over the years.

- **Fresh grocery – an example of "path-dependent" expansion:** The fresh grocery category has low penetration and thus has been an attractive opportunity for e-Commerce players, which used heavy subsidies to expand quickly. After regulatory reset, online grocery market growth inevitably slowed down, and subsidies were reduced. Yet e-Commerce players are still used to their tried-and-true "over-subsidy" expansion strategy when expanding into new businesses or categories, which is no longer encouraged by the current regulatory environment.

The intense involution in China's e-Commerce market has led to fast-diminishing marginal benefit of every sales and marketing dollar that the companies have invested over the past two years.

4. Key impacts from regulatory reset

The regulatory environment after reset could mitigate the trend of involution in the e-Commerce market and prevent irrational competition to some extent. And e-Commerce platforms will focus more on effective cost control, which could lead to better profitability in the next few years.

We believe the current regulatory environment has depleted the ability of leading e-Commerce platforms to leverage their tried and trusted over-subsidy expansion strategy to explore the next growth drivers in the future. This makes it more difficult for e-Commerce players to accelerate their growth while the overall market is decelerating.

5. How to invest in China's e-Commerce market after regulatory reset

We believe the e-Commerce market-wide growth slowdown will leave limited opportunity for e-Commerce platforms to re-rate until any player could find a meaningful new growth driver.

As such, we suggest being more selective and focusing on players that have above-segment revenue and earnings growth prospects.

We prefer JD and Pinduoduo because we expect them to outperform the market:

- *JD* – 12.9% revenue CAGR over 2022-25e, 29.4% non-GAAP earnings CAGR over 2022-25e; and

- *Pinduoduo* – 18.3% OMS revenue CAGR, 31.7% earning CAGR.

We remain more conservative on Alibaba and Vipshop because we expect them to generate below-market growth:

- *Alibaba* – 9.8% China Commerce revenue CAGR, 19.0% earnings CAGR; and
- *Vipshop* – 1.7% revenue CAGR, 0.8% earnings CAGR.

Where there could be further risk of regulatory tightening

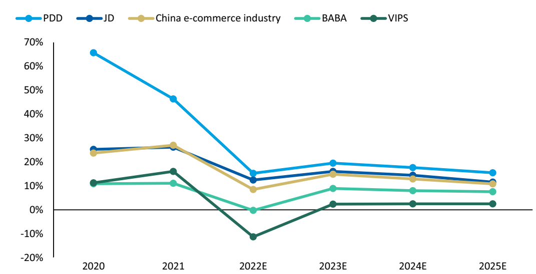
We believe data security is one of the key areas of regulatory focus in the future – and this is also most related to e-Commerce platforms because they have large amounts of consumer data. Although we expect a stable regulatory environment from now, the standard of regulation is higher than before, which requires e-Commerce platforms to upgrade their internal controls and infrastructures for data security. Any leakage of sensitive data or violation of data security regulations could potentially prompt further regulatory tightening for the whole market.

Gauging the threat of disruption from new technologies such as live streaming e-Commerce and other future tech

We believe "new technologies" like live streaming e-Commerce are not able to bring incremental consumption to the e-Commerce market, but will only lead to involution and drag down the overall profitability and ROI of the market. As such, we are conservative on so-called "new tech" like live streaming, but more constructive on real "new tech," which could make the market pie bigger, bring incremental consumption demand, and improve merchants/platforms' ROI. Although it is still unknown what the "new tech" could be, we will watch for the above-mentioned characteristics to assess the market impact.

Key Charts

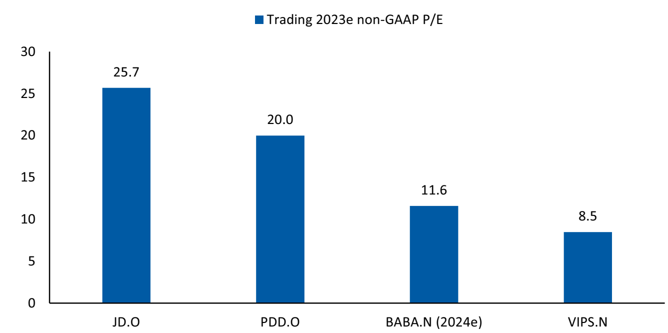
Exhibit 1: China's e-Commerce GMV growth (yoy)



	2020	2021	2022E	2023E	2024E	2025E
PDD	65.7%	46.4%	15.3%	19.5%	17.6%	15.5%
JD	25.3%	26.2%	12.4%	16.0%	14.5%	11.6%
China e-commerce industry	23.7%	27.0%	8.5%	14.9%	12.9%	10.8%
BABA	10.9%	11.1%	-0.2%	9.0%	8.0%	7.6%
VIPS	11.3%	16.1%	-11.3%	2.4%	2.5%	2.5%

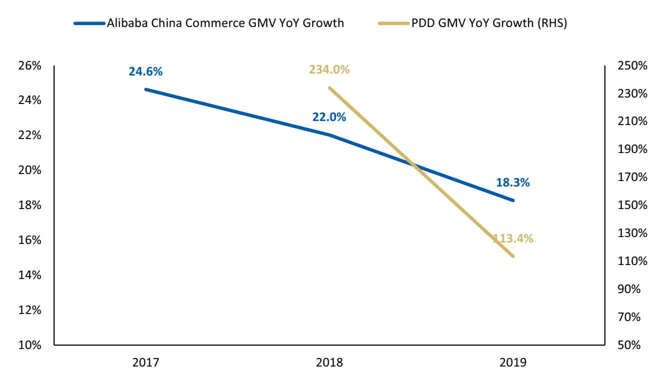
Source: Company data, Morgan Stanley Research Estimates

Exhibit 2: China's e-Commerce: trading 2023e non-GAAP P/E



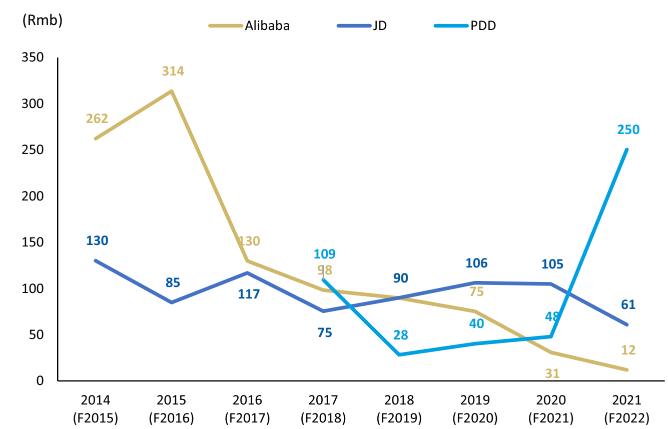
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Estimates, Note: price as of July 20th 2022

Exhibit 3: Pinduoduo's initial expansion brought incremental demand and did not severely hurt Alibaba's growth



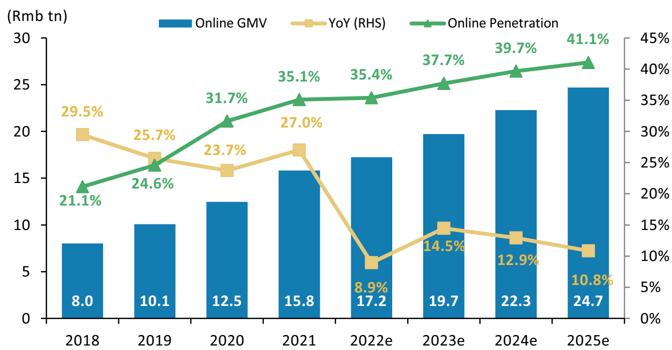
Source: Company data, Morgan Stanley Research

Exhibit 4: S&M ROI: marginal GMV change brought by marginal S&M spending change



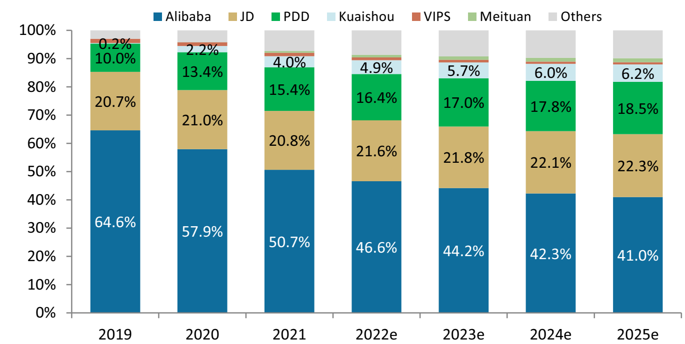
Source: Company data, Morgan Stanley Research Note: F2015-F2022 for Alibaba

Exhibit 5: We expect China's e-Commerce GMV growth to moderate in 2022-24e



Source: Company data, Morgan Stanley Research Estimates (E)

Exhibit 6: We expect a continuous decentralization of China's e-Commerce market



Source: Company data, Morgan Stanley Research Estimates (E)

1. Recap of Regulatory Reset

Since 2020, policymakers have adopted stricter regulations on China's e-Commerce market related to antitrust and prevention of disorderly capital expansion, social security for flexible workers, data privacy, data security, etc. We believe the regulatory reset has currently moved to a standardized and more predictable stage.

1. Antitrust and prevention of disorderly capital expansion

Key regulatory issues/concerns

- Chinese government concerns over anti-monopolistic behavior have led to new regulations aimed at tackling unfair competition in the Internet industry. Key monopolistic practices include:
  - Forced exclusivity ("2-choose-1"),
  - Price discrimination based on user data/algorithms,
  - Improper behavior in community group buying (including dumping and price fraud), etc.
- China's regulators have tightened scrutiny of M&A, specifically on historical transactions failing to report business concentration information.

Regulatory events

January 2020: The State Administration for Market Regulation (SAMR) published a draft amended Anti-Monopoly Law for public comment.

November 2020: SAMR released draft guidelines for anti-monopoly laws, and tightened scrutiny of various monopolistic practices to tackle unfair competition in the Internet industry, including price discrimination among consumers based on user data, bundled sales, predatory pricing, and restricting businesses to sell or offer services on rival platforms ("2-choose-1").

December 2020: SAMR held an administrative guidance meeting on regulating the community group buying (CGB) businesses, which was attended by Alibaba, Tencent, JD, Meituan, Pinduoduo, and DiDi. The meeting requires Internet platforms to strictly regulate the CGB business and abide by the "nine forbidden practices":

1. Must not abuse their independent pricing power through low-price dumping, price collusion, bidding up prices, price fraud, etc.
2. Must not illegally reach or implement any form of monopoly agreement.
3. Must not abuse dominant market position, by means such as predatory pricing, etc.

4. Must not illegally implement concentration of business operators or exclude/restrict competition.

5. Must not carry out any unfair competitive acts.

6. Must not implement big data price discrimination.

7. Must not utilize technological means to damage the order of competition.

8. Must not collect and user consumers' personal information illegally.

9. Must not sell fake and shoddy products.

*February 2021***:** SAMR released the final version of China's new antitrust regulations targeting platform economies. Since then, SAMR has issued fines for various anti-monopoly practices to different companies.

April 2021: SAMR imposed a US$2.8bn fine on Alibaba for abusing market power. In the same month, SAMR launched an investigation into suspected monopolistic practices by Meituan, including forced exclusivity arrangements.

June 2021: Regulators required several CGB players, including Pinduoduo and Meituan, to remove the "Rmb0.01 flash sale" promotion subsidy.

July 2021: SAMR banned the merger of video game streamers HUYA and DouYu, and ordered Tencent Music to give up its exclusive music licensing rights, but it did approve Tencent's Sogou acquisition.

August 2021: SAMR issued a draft opinion to ban unfair competition, such as using big data and algorithms to affect consumers' choice and divert traffic from rivals.

September 2021: The Ministry of Industry and Information Technology (MIIT) required platforms to unblock external links in accordance with standards starting from September 17.

October 2021: SAMR imposed a US$530mn (Rmb3.4bn) fine on Meituan as a result of its five-month anti-monopoly probe launched in April. In addition, the regulator ordered Meituan to return Rmb1.29bn of exclusivity deposits in full to its partners.

October 2021: SAMR proposed guidelines to the implementation of the responsibilities that Internet platforms are to uphold. SAMR defined what it considered to be "super large platforms" for the first time, saying that more would be expected from them, especially in areas of data protection, treatment of workers, and fair competition.

Implications

- Forced exclusivity practice in e-Commerce/transaction platforms will not be allowed, which has led to more rational competition among e-Commerce platforms.
- More moderate M&A pipeline amid ongoing reviews, market consolidation transactions that cannot ensure competition appear at risk – e.g., Tencent to reduce stakes in JD and SEA.

- Alibaba and Tencent to gradually open up ecosystems under pressure from tightening antitrust regulations – e.g., WeChat to allow direct links to Taobao.
- Normalized subsidy levels in the CGB businesses, leading to more rationalized competition.

2. Social security for flexible workers

Key regulatory issues/concerns

- The Chinese government has increased its focus on the safety and rights of flexible employees, and aims to provide a clear framework on social security for flexible employment and whether Internet platforms should take corresponding responsibilities.

Regulatory events

July 2021: The Ministry of Human Resources and Social Security (MOHRSS) and seven other departments issued guidelines protecting worker rights in new labor forms, and suggested enterprises should guide and support flexible employers to participate in social insurance according to their own conditions.

July 2021: SAMR and six other departments jointly issued detailed guidelines on protecting food delivery riders' rights and interests. Highlights of the guidelines include the platform's need to take responsibility for ensuring riders' minimum income, as well as food safety, improving order dispatch systems, improving working conditions, etc. More importantly, the guidelines also specified different requirements for platforms and agencies toward riders in different labour relationships.

August 2021: MOHRSS and other regulators called for better protection of labor safety and labor rights at a meeting with delivery firms. Policymakers suggested some implementation flexibility on social pension and insurance contribution for "flexible employees" at a State Council weekly briefing.

January 2022: Eight government departments including MOHRSS issued guiding opinions on protecting the labor rights and interests of workers employed in new forms.

Implications

- The guidelines acknowledge a new format of flexible employment, highlighting regulators' focus on protecting their rights, which should be beneficial for the longer-term healthy development of industries, such as food delivery and ride hailing.

3. Data privacy and data security

Key regulatory issues/concerns

- Increased regulatory focus on protection of personal information and seeking to prevent breaches of online privacy. According to regulators, key data collection irregularities include illegal collection, over-collection, and excessive requests for authorization.

- Increased scrutiny of cross-border data flow and change in government stance on overseas listings to reduce external funding risk given US PCAOB rules.

Regulatory events

March 2021: CAC finalized a new policy defining the scope of necessary personal information for 39 common types of mobile phone applications and prohibited the operators of the apps from collecting “unnecessary” personal information from users.

April 2021: The draft of China's first law on *Personal Information Protection (PIPL)* was submitted to the Standing Committee of the National People's Congress, the country's top legislature, for a second review.

June 2021: China officially passed the *Data Security Law* (effective September 2021). This law provides more clarity around data collection, usage, and cross-border transmission, particularly for critical infrastructure operators.

July 2021: CAC undertook cybersecurity investigations into various US-listed firms including DiDi and Boss Zhipin, suspending the new user registration of those platforms.

July 2021: CAC released a new draft of the *Cybersecurity Review Measures* that proposes all Internet operators dealing with over 1mn users' personal information be subject to cybersecurity review when seeking foreign listings.

August 2021: China's Computer Network Emergency Response Technical Team/Coordination Center (CNCERT/CC) found 14 apps to have violated user privacy by collecting personal information without permission.

August 2021: The State Council issued an administrative regulation, asking operators of major IT infrastructure projects to ensure cybersecurity.

July 2022: CAC finalized the *Measures for Security Assessment for Cross-border Data Transfers* (effective September 2022), which expands and clarifies requirements for companies to protect data and networks in several areas, including handling of "important" data, cross-border data transfer, personal information protection, and responsibilities of Internet platforms. Data controllers that have exported the personal information of 100,000 people or sensitive personal information of 10,000 people are subject to security assessments.

Implications

- Chinese companies will apply more stringent controls on user data protection to be compliant with new regulations on collecting personal information from users.
- Data-heavy companies that are seeking foreign listings will potentially face CAC review.

Regulatory reset has moved to a standardized and more predictable phase

We believe Vice Premier Liu He's speech at the Financial Stability Committee meeting on March 16 marked an inflection point for the regulatory reset cycle for China's Internet companies. Following Liu He's speech, a series of events has proved that the regulatory reset has moved to a standardized and more predictable phase:

- *March 16:* the CSRC issued a press release emphasizing that a collaborative arrangement that meets the legal and regulatory requirements of both China and the US could be reached as soon as possible. This sounded more promising than prior comments. We're also encouraged to see Bilibili's announced pursuit of voluntary conversion to dual-primary listing on HKEx – others with secondary listing may follow.

- *April 11*: game licensing approval resumed after an eight-month freeze since July 2021.

- *April 29:* the Politburo meeting chaired by President Xi called for the most concerted efforts since 2018 to stabilize the economy, and held a more supportive tone by vowing to roll out measures to support the healthy development of the platform economy and standardize regulatory oversight.

- *June 6:* the *Wall Street Journal* reported that the cybersecurity investigation into several companies (including Boss Zhipin and DiDi) since July 2021, which has been one of the largest overhangs for China's Internet industry, could conclude soon. Conclusion of the investigation could lead the suspension of new user registration for these companies to be lifted.

- *June 7:* the second batch of game licenses was released.

- *June 10*: DiDi delisted its ADS from the NYSE. Given that DiDi's delisting was a prerequisite for completion of the cybersecurity review and rectification (link), we believe this serves as a positive signal that the cybersecurity review could be concluded soon.

- *June 29:* Boss Zhipin announced on its official Weibo account that it would resume new user registration. We believe the resumption of new user registration indicates that the cybersecurity investigation could be completed soon. See Kanzhun Ltd: The Long-Awaited New User Registration Resumption (29 Jun 2022).

- *July 21:* CAC fined DiDi Rmb8.026bn, and also levied fines of Rmb1mn on both its founder and Chief Executive, Cheng Wei, and President, Jean Liu, because they were responsible for the violations. This marks the conclusion of its cybersecurity review.

- *July 26:* Alibaba announced an application for the conversion from a secondary listing on the Main Board of HKEX to primary listing status, which it expects to become effective before end-2022. Upon approval and completion, it will have a dual primary listing on the HKEX and NYSE, which would signal an incremental easing of the regulatory risk overhang.

We believe regulatory tightening on Internet companies is now entering a stage of regulatory easing, and we expect a more stable and visible regulatory environment.

Exhibit 7: Regulatory reset: moving to a standardized and more predictable phase

Areas of focus	Financial Stability Committee meeting (March 16)	Politburo meeting (April 29)	Future signposts
Big Tech	**Guidance:** • US and China are working on a concrete coordination plan for ADR auditing • Regulation of big tech firms needs to be more transparent and predictable **What happened:** • Regulators in China and the US are cooperating; the CSRC said a deal could be reached • Approvals of game licenses resumed in early April, after a 10-month hiatus	• **Wrap up regulatory work and standardize regulatory oversight** • **Roll out measures supporting healthy development of the platform economy** **What happened:** • WSJ reported on June 6 that investigations on several data-heavy companies would be concluded soon	• China may grant access to audit papers of less sensitive firms • Outcome of data security review on data-heavy internet platforms • Details on riders' social security arrangement clarified • Chinese firms resume offshore IPOs, with data-rich tech firms getting listed in Hong Kong and firms in less sensitive sectors getting listed in the US

Source: Morgan Stanley Research

2. Covid Boosted Growth but Overdrew Growth Potential

Over the past two years, the Covid outbreak not only further boosted e-Commerce penetration to 31-32% but also pushed e-Commerce users to a ceiling – online shopping users were 82% of total Internet users in China as of 2021.

However, this is more short-term gain and long-term pain for the e-Commerce market, which we believe has overdrawn its growth potential for the next few years. This has led to increasing competition and brought forward e-Commerce platforms' schedule for looking for their second growth drivers.

Consumer/merchant behavior change during the Covid outbreak boosted e-Commerce penetration – but also overdrew its growth potential

The pandemic has reshaped a number of dimensions of consumer behavior, by moving some traditional activities from offline to online, such as grocery shopping, education, working, etc. Merchants also place more importance on online channels to diversify the risks to offline sales from Covid lockdowns. This consumer/merchant behavioral change during Covid effectively boosted China's e-Commerce penetration rate to a pretty high level, such that we have seen online penetration flatten or even decline slightly as the Covid situation has normalized.

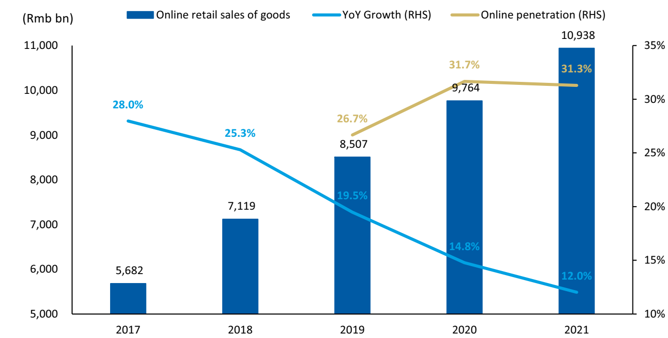
- **Thus, we argue that the Covid boost to online penetration has overdrawn e-Commerce's growth potential.**

Our observations of annual, quarterly, and by-category online penetration support our view:

- China's e-Commerce penetration surged from 26.7% in 2019 to 31.7% in 2020, followed by a slight decline in 2021 to 31.3% amid a more normalized Covid situation, per NBS (Exhibit 8).
- If we look further into quarterly numbers, China's e-Commerce penetration increased 6.7ppt yoy in 1Q20 and 6.4ppt yoy in 2Q20 during the Covid outbreak, and further improved 1.8ppt yoy in 2Q22 during the Omicron wave following a stabilized online penetration rate in 1Q-4Q21, per NBS (Exhibit 9).
- By category (Exhibit 10), according to Euromonitor, online penetration rate of:
    - Apparel and footwear grew from 24.9% in 2019 to 35.2% in 2020, and 35.4% in 2021.Beauty and personal care grew from 31.3% in 2019 to 37.9% in 2020, and 38.6% in 2021.
    - Consumer appliances grew from 39.6% in 2019 to 45.9% in 2020, and 43.5% in 2021.

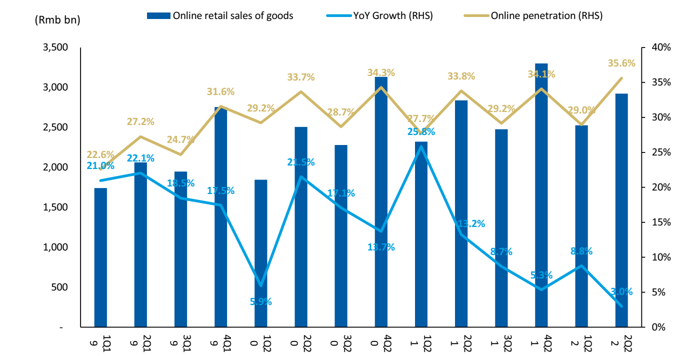
- Consumer electronics grew from 38.4% in 2019 to 40.3% in 2020, and 41.1% in 2021.
- Food and beverages grew from 11.7% in 2019 to 14.7% in 202,0 and 15.7% in 2021.

Exhibit 8: China – online sales and online penetration (annual)



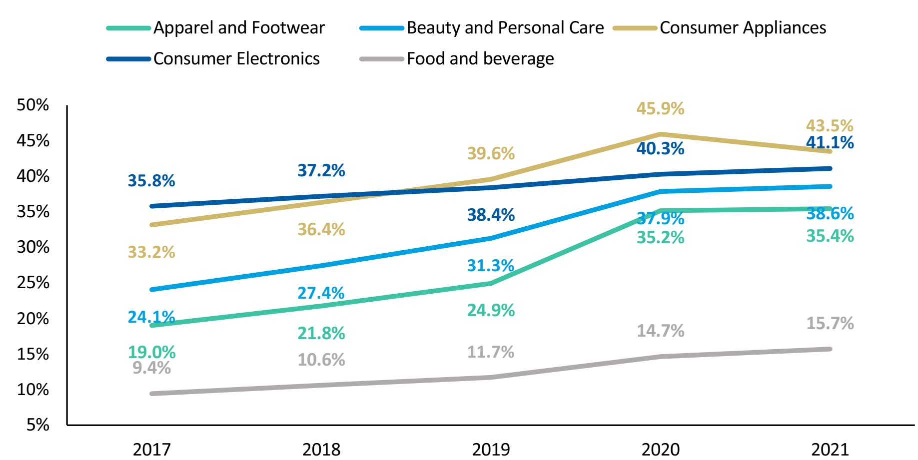
Source: NBS, Morgan Stanley Research Note: online penetration exclude catering and auto sales

Exhibit 9: China – online sales and online penetration (quarterly)



Source: NBS, Morgan Stanley Research

Exhibit 10: Online penetration rate for major categories

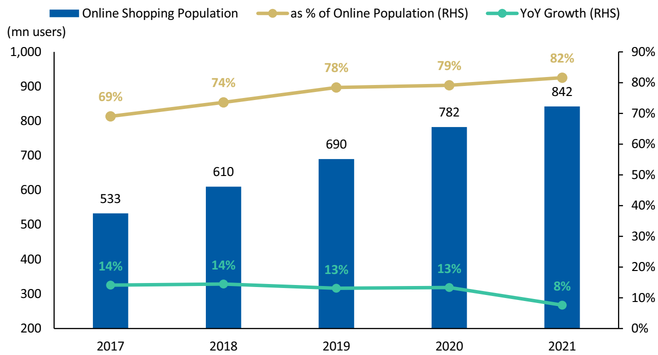


Source: Euromonitor, Morgan Stanley Research

User traffic is also near a ceiling

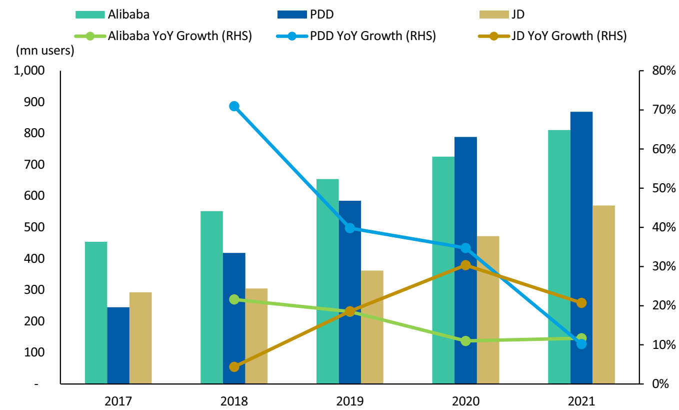
E-Commerce user traffic has approached a ceiling, in our view, with online shopping users accounting for 82% of total Internet users in China as of 2021 (Exhibit 11), and user growth for China's three major e-Commerce platforms – Alibaba, Pinduoduo, and JD – slowing down significantly from 11%, 35%, and 30% in 2020 to 12%, 10%, and 21% in 2021, respectively (Exhibit 12).

Exhibit 11: Online shopping has penetrated 82% of Internet users in 2021



Source: CNNIC, Morgan Stanley Research

Exhibit 12: User growth slowdown for Alibaba, Pinduoduo, and JD



Source: Company data, Morgan Stanley Research

3. Main Areas of Competition

We identify three main areas of competition in China's e-Commerce segment in the past few years, which we expect to continue.

- **Live streaming e-Commerce – an example of e-Commerce involution:** Live streaming shopping has emerged as a new e-Commerce format and shown rapid growth during Covid. However, we believe live streaming e-Commerce generates little incremental online TAM given its focused categories already have high e-Commerce penetration (such as apparel and cosmetics), leading to excessive competition with limited resources and thus involution.

- **Lower-tier cities – an example of e-Commerce involution:** Pinduoduo has effectively made the market pie bigger by bringing new online TAM from lower-tier cities. Alibaba's launch of Taobao Deals and JD's Jingxi could only lead to involution because e-Commerce penetration in lower-tier cities has reached a high level over the years.

- **Fresh grocery – an example of "path-dependent" expansion:** The fresh grocery category has low penetration and thus has been an attractive opportunity for e-Commerce players, which used heavy subsidies to expand quickly. After the regulatory reset, online grocery market growth inevitably slowed down, and subsidies were reduced. Yet e-Commerce players are still used to their tried-and-true "over-subsidy" expansion strategy when expanding into new businesses or categories, which is no longer encouraged by the current regulatory environment.

The intense involution in China's e-Commerce market has led to fast-diminishing marginal benefit of every sales and marketing dollar that the companies have invested over the past two years.

Live streaming e-Commerce – involution in highly penetrated categories

Live streaming e-Commerce emerged as a new format of shopping and showed remarkable growth during Covid. Live streaming/short video platforms like Douyin and Kuaishou were the major disrupters of China's e-Commerce market, as they leveraged their large and engaged user base and cultivated consumers' habit of shopping on their platforms. Traditional e-Commerce platforms are also placing more live streaming and short-video content with fees on their landing pages and product description pages.

However, live streaming is not able to bring much incremental growth for the whole e-Commerce market. Instead, it is cannibalizing traditional e-Commerce platforms' share, leveraging stronger traffic momentum, but at the cost of dragging down the profitability of the whole market.

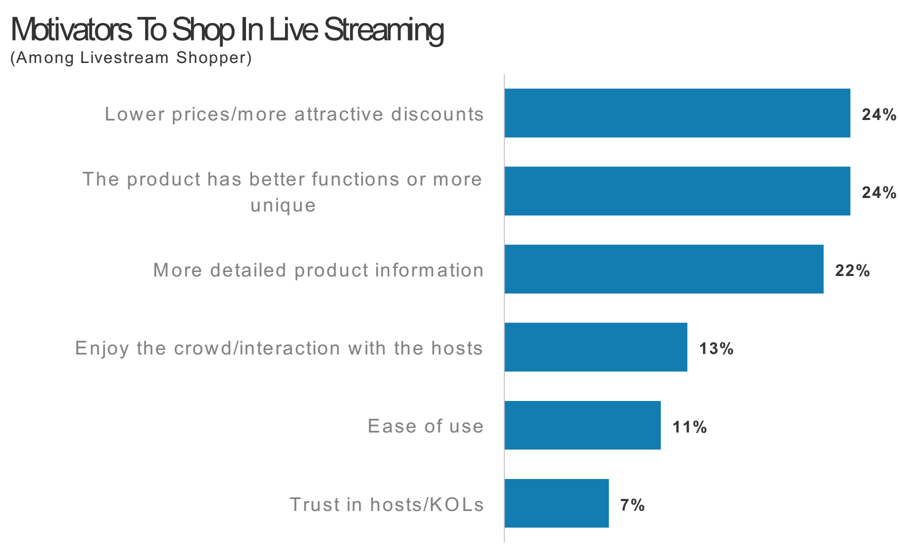
1. Live streaming e-Commerce creates value for both consumers and brands

We believe the value that live streaming e-Commerce creates lies in these areas:

- **For consumers:** Live streaming upgrades consumers' pre-sale shopping experience – they could enjoy better discounts on a daily basis vs. traditional e-Commerce platforms, which concentrate discounts on shopping festivals. Also, real-time interaction with live streaming hosts enables them to understand product details better. AlphaWise evidence shows that pricing/discounts and better products tie as the biggest factors in enticing live streaming shopping, as rated by 24% of consumers each, followed by more detailed product presentation at 22%) (Exhibit 13).

- **For brands/merchants:** Live streaming is an efficient marketing/sales channel – live streaming hosts are able to help merchants aggregate sizable demand within a short period of time, accumulate private domain traffic, and improve brand awareness.

Exhibit 13: Pricing/discounts and better products tie as the biggest factors in enticing live streaming shopping, as rated by 24% of consumers each, followed by more detailed product presentation (22%).



Source: AlphaWise, Morgan Stanley Research

2. Live streaming e-Commerce takes wallet share mainly in categories that are already highly penetrated with slow growth

According to Euromonitor, online penetration of apparel and footwear grew ~10ppt from 24.9% in 2019 to 35.2% in 2020 and 35.4% in 2021, while beauty and personal care increased ~7ppt from 31.3% in 2019 to 37.9% in 2020 and 38.6% in 2021. As highlighted earlier, we think Covid "over-boosted" the e-Commerce penetration rate in 2020, so that we saw online penetration flatten or even decline slightly in 2021, leaving limited room for further growth of the whole e-Commerce market. Thus, for these highly penetrated categories, we believe live streaming e-Commerce mainly takes wallet share from traditional e-Commerce, rather than making the market pie much bigger.

Brands' costs through live streaming e-Commerce channels are usually higher than on traditional e-Commerce platforms. Major cost items for merchants include:

- Up-front payment to live streaming hosts in order to secure a position in their live streaming shows;
- Commission fees to live streaming hosts/platforms (ranging from 30%-50% of total GMV);
- Heavy subsidies/discounts to attract consumers and/or accommodate the requirements of the hosts.

Some brands might choose to create their own live streaming studios, but they still need to pay for traffic support, hire a live streaming team, and/or pay for the operation/marketing services provided by the live streaming service providers.

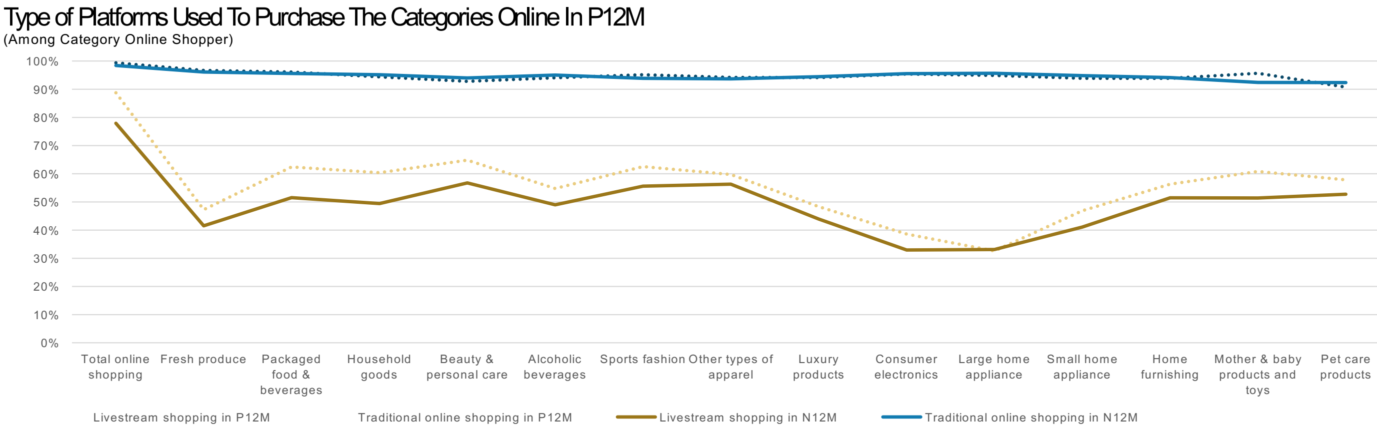
We believe the nature of live streaming e-Commerce determines its adoption to be higher in categories that have one or more of the below features:

- Low standardization (live streaming can better communicate product features), such as apparel and cosmetics;
- Low AOV (live streaming can aggregate sizable demand), such as household goods;
- High gross margins (brands could afford high related costs), such as apparel, cosmetics and jewelry;
- High repurchase rate (brands could afford high related costs), such as apparel.

On the other hand, we see less room for live streaming e-Commerce to penetrate in categories like 3C/home appliances, which are more standardized, have higher AOV, lower gross margins than apparel/cosmetics, and lower repurchase rates. Besides, consumers care more about after-sale services (installment, return, maintenance, insurance, etc.) for 3C/home appliances.

Our AlphaWise survey supports our view from the perspectives of product category penetration. Our survey shows live streaming shopping is more prevalent in beauty & personal care (65%), athletic clothing & shoes (63%), packaged food & beverages (62%), mother & baby products (61%) and household goods (60%), but less so in home appliance (33% large vs. 47% small), consumer electronics (39%) and luxury products (48%) (Exhibit 14).

Exhibit 14: Live streaming e-Commerce adoption is higher in categories like apparel, cosmetics, home furnishing, and pet care

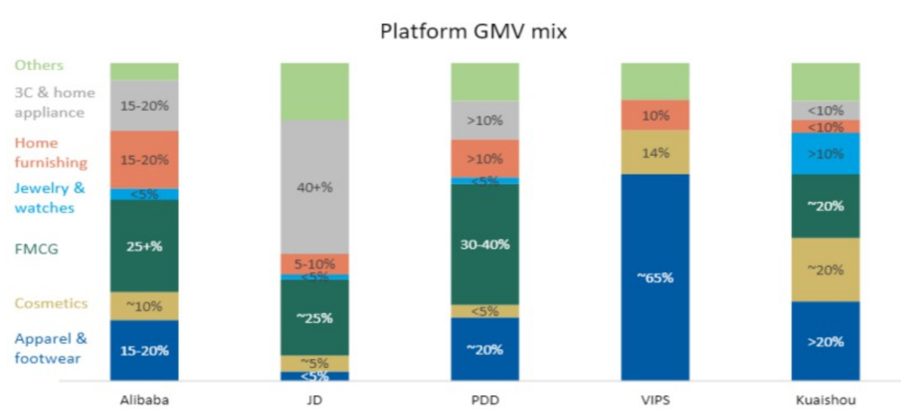


Source: AlphaWise, Morgan Stanley Research

See the related report: Disruption Decoded – China Internet: Livestreaming E-Commerce Competition Is On Air (26 July 2022).

Thus, we think JD is less disrupted by live streaming e-Commerce given its core category focus on 3C/home appliances, whereas Alibaba, Pinduoduo, and Vipshop have higher risks of losing market shares to Douyin and Kuaishou given their higher exposure to apparel, cosmetics and jewelry. We estimate that Taobao/Tmall, Vipshop, Pinduoduo, and JD generated ~30%, 70-80%, ~25%, and 10-15%, respectively, of their GMV from apparel, cosmetics, and jewelry (Exhibit 15).

Exhibit 15: We estimate that Taobao/Tmall, Vipshop, Pinduoduo, and JD generated ~30%, 70-80%, ~25%, and 10-15%, respectively, of their GMV from apparel, cosmetics, and jewelry

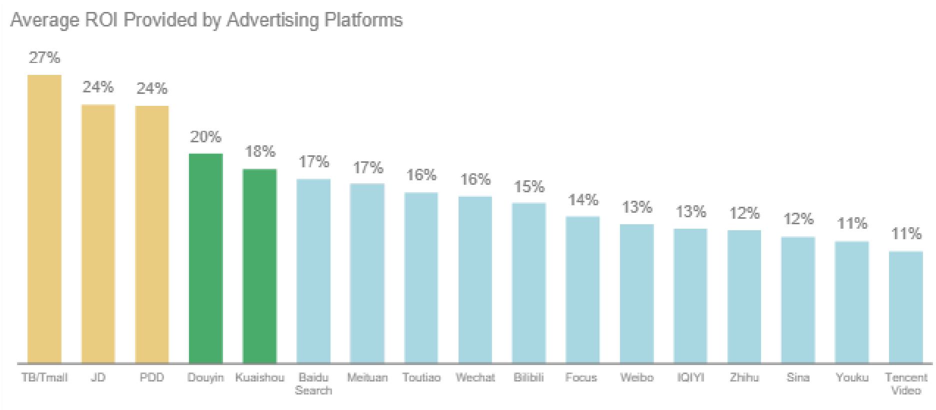


Source: Vipshop data based on 1P revenue; Morgan Stanley Research estimates

3. Live streaming e-Commerce platforms do not bring higher ROI to brands (vs. traditional e-Commerce platforms), but drag down the profitability of the e-Commerce market

Our AlphaWise survey shows that CMOs see lower ROI on Douyin (20% perceived ROI, per respondents) and Kuaishou (18%) than on traditional e-Commerce platforms (24-27%) – see Exhibit 16. This indicates that competition from live streaming platforms led to e-Commerce involution because they were not able to meaningfully enhance brands' ROI and thus profitability.

Exhibit 16: CMOs see better ROI on traditional e-Commerce platforms (24-27% perceived ROI, per respondents) than on Douyin (20%) and Kuaishou (18%)



Source: AlphaWise, Morgan Stanley Research

See the related report: China Advertising: Stuctural Headwinds amid Cyclical Tailwinds (27 February 2022).

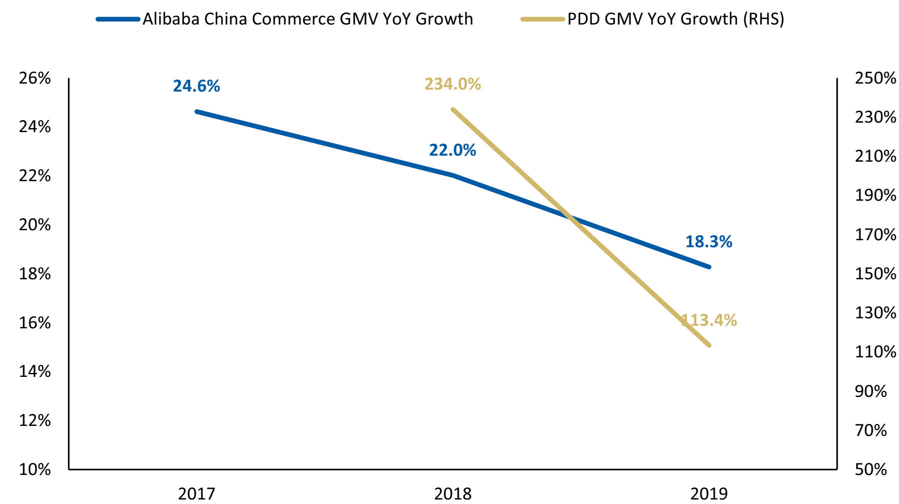
Lower-tier cities – involution in specific user groups

1. The rise of Pinduoduo – an example of non-involution competition in China's e-Commerce history

Consumers from lower-tier cities tend to emphasize value for money rather than brand value. Pinduoduo initially started from the lower-tier city consumer group, which had low e-Commerce penetration (36.8% for Tier 3 cities vs. 61.4% for Tier 1-2 cities in 2018, per iResearch) and were underserved by major e-Commerce platforms like Alibaba and JD for some time. Pinduoduo has effectively made the market pie bigger by penetrating the lower-tier city user group, increasing online penetration in value for money categories and agricultural products, which we argue is the opposite of e-Commerce involution.

During 2017-2019, Pinduoduo's GMV grew from Rmb141bn to Rmb1tn. Although Alibaba's GMV growth slowed down during the same period, the extent of the GMV slowdown was very moderate – i.e., from 24.6% yoy in 2017 to 18.3% yoy in 2019 (Exhibit 17). We believe the major reason behind this is that Pinduoduo had explored a new market and brought incremental growth to the whole e-Commerce market, which did not lead to involutionary competition.

Exhibit 17: GMV yoy growth comparison: Alibaba and Pinduoduo



Source: Company data, Morgan Stanley Research

2. In contrast, Alibaba's launch of Taobal Deals and JD's Jingxi are examples of involution

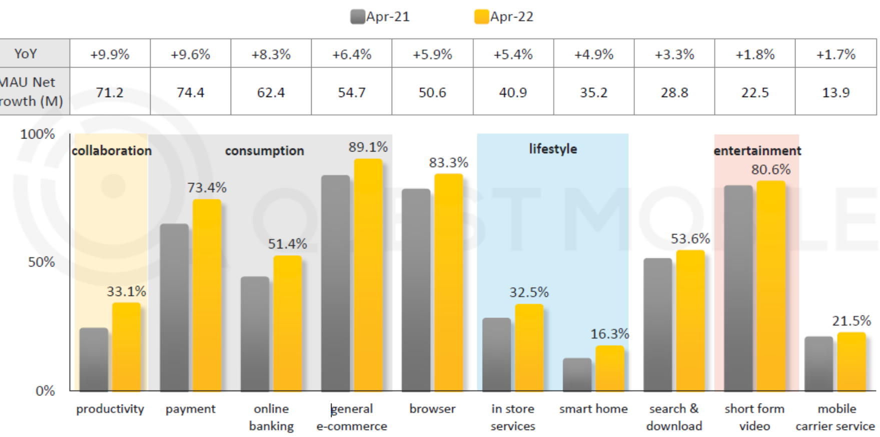
Following Pinduoduo's success, JD launched Jingxi in November 2019 and Alibaba launched Taobao Deals in March 2020. However, we believe e-Commerce penetration in lower-tier cities has approached a ceiling, leaving limited room for new entrants – per Questmobile, e-Commerce penetration in lower-tier cities (e-Commerce MAU from lower-tier cities as a percentage of mobile Internet MAU from lower-tier cities) improved moderately: 6.4ppt yoy, to 89.1% in April 2022 (Exhibit 18).

Over the past three years, the old way of using aggressive subsidies to attract users has not prevailed as it used to, though Pinduoduo has proved it to be the most effective way to attract users from lower-tier cities. Up to now, Taobao Deals is still loss-making and loss reduction has been a top priority for Alibaba. For Jingxi, after several rounds of layoffs and business optimization, JD disbanded Jingxi Business Group in June 2022. This shows how e-Commerce involution leads to low ROI for new entrants in the already highly penetrated lower-city user groups.

Exhibit 18: E-Commerce penetration for lower-tier cities improved moderately: 6.4ppt yoy, to 89.1% in April 2022

Top 10 Sub-categories by Increase of Share of Active Users From Lower Tier Cities

YoY	+9.9%	+9.6%	+8.3%	+6.4%	+5.9%	+5.4%	+4.9%	+3.3%	+1.8%	+1.7%
MAU Net Growth (M)	71.2	74.4	62.4	54.7	50.6	40.9	35.2	28.8	22.5	13.9



Source: Questmobile TRUTH, April 2022, Morgan Stanley Research Note: (1) market penetration rate/share of active users: (market MAU)/(mobile Internet MAU); (2) net addition: (market MAU in Apr 2022)-(market MAU in Apr 2021); (3) sort the secondary mobile Internet industries (MAU>100mn) by yoy active penetration in descending order

Fresh grocery – path-dependent "over-subsidy" expansion strategy in categories with lower penetration

In light of the user/GMV growth slowdown over the past two years, e-Commerce platforms were aggressively looking for a new growth driver – and they found the fresh grocery/daily necessities categories. E-Commerce penetration for the fresh grocery/daily necessities categories has been quite low (~4% in 2019 and ~10% in 2021, per our estimates) vs. other categories like apparel, 3C/home appliances, etc. Moreover, there are potential cross-selling opportunities brought by the grocery categories – high purchase frequency but low ASP – to the categories with lower purchase frequency but high ASP .

Various business models emerged, including CGB, frontline fulfillment, on-demand delivery, etc. Major e-Commerce platforms like Alibaba (Taocaicai), Pinduoduo (Duo Duo Grocery), Meituan (Meituan Select), and JD (Jingxi Pinpin) were also trying to penetrate the grocery market, hoping it could become their new growth driver. They burned cash and offered heavy subsidies in order to attract consumers, turning the competition into a "subsidy war."

In December 2020, SAMR held a meeting on regulating the CGB businesses, which was attended by Alibaba, Tencent, JD, Meituan, Pinduoduo, and DiDi. The meeting required Internet platforms to strictly regulate the CGB business and abide by the "nine forbidden practices," including not abusing their independent pricing power through low-price dumping, price collusion, bidding up prices, price fraud, etc. On June 2021, regulators required several CGB players, including Pinduoduo and Meituan, to remove the "Rmb0.01 flash sale" promotion subsidy.

Online grocery market growth inevitably slowed down after regulatory reset with reduced subsidies, which we will discuss in more detail in the next section of this report (Key Impacts of Regulatory Reset).

However, what concerns us more is that, instead of business model innovation or technological innovation, leading e-Commerce players in China are still used to their path-dependent "over-subsidy" strategy when expanding into new business or categories, which is no longer encouraged by the regulatory environment.

Fast-diminishing marginal benefit

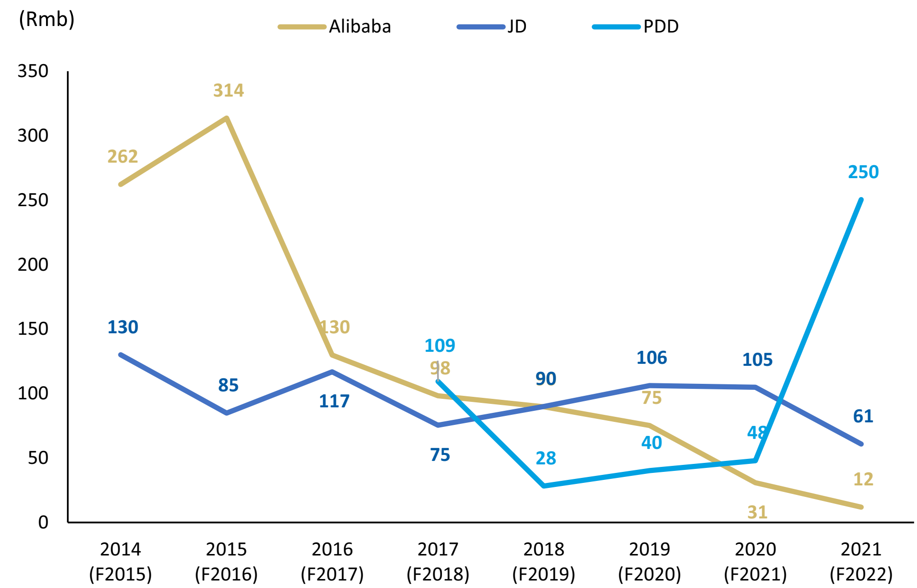
Our analysis of incremental GMV change brought by every additional S&M dollar spent in the past several years supports our view that user growth slowdown and e-Commerce involution led to deteriorating returns (Exhibit 19).

Particularly for Alibaba, its S&M ROI gradually declined during 2016-19 despite the competition from both Pinduoduo and JD, and showed sharper declines in 2020 and 2021 with heavy investments in new businesses (mainly Taobao Deals and Taocaicai) and involution in the e-Commerce market.

JD's return on S&M spending also declined in 2021 with investments in new businesses (mainly CGB business).

In contrast, however, Pinduoduo's return on S&M spending showed an increasing trend as the company shifted its strategy and no longer spent aggressively on S&M to acquire new users since 2H21.

Exhibit 19: S&M ROI: Marginal GMV change brought by marginal S&M spending change



Source: Company data, Morgan Stanley Research Note: F2015-F2022 for Alibaba

4. Key Impacts of Regulatory Reset

On the positive side, we believe the regulatory environment after regulatory reset could mitigate the trend of involution in the e-Commerce market and prevent irrational competition to some extent. In addition, leading e-Commerce platforms will adopt more effective cost control and scale back cash-burning business, which will lead to improving profitability in the near to medium term.

On the negative side, current regulatory environment (with more stringent requirements for cybersecurity) will make it more difficult for leading e-Commerce platforms to find new growth drivers leveraging their old subsidy-driven expansion strategy.

As such, we expect growth of the e-Commerce market and leading platforms is set to slow down before they find meaningful new growth drivers.

Positive impact – more rational competition and better profitability

1. E-Commerce platforms are more prudent in user acquisition and new business investments, amid a more rational competitive environment

Since June/July 2021, competition in CGB began to ease in response to the stricter regulatory environment. Further into 2022, after regulatory reset, we have come to an era when the model of traffic-driven growth supported by subsidies is being replaced by one oriented to user quality and operating efficiency. Platforms are now more prudent in their user acquisition and expansion into new businesses, with more focus placed on efficiency and margins. We believe competition among e-Commerce platforms will become more rational, and the key focus areas of competition have switched to increasing user engagement, purchase frequency, and ARPU, along with enhancing mind share within the existing user base.

We summarize messages from companies' earnings calls on the key user/new business strategies or company comments in the past few quarters.

JD:

- **User strategy:**
  - *4Q21:* "China's Internet industry developed into a more mature stage"; focus on quality user growth, improving user mind share and engagement, supported by an increase in user purchase frequency and a widening in the range of categories purchased.
  - *1Q22:* JD made proactive adjustments to user strategy, and is increasingly focusing on improving user quality.

- **New business strategy:**
  - *1Q21:* Jingxi covered 17 provinces and is well on track with expansion.
  - *2Q21:* Jingxi Pinpin recorded >300% qoq daily order/GMV growth and active users grew faster; followed the commitment to speed up investment in CGB.
  - *3Q21:* Jingxi proactively focused its operation in selected markets (10 provinces in 3Q21 vs. 20+ in 2Q21), improving operating efficiency and UE (unit economics); management emphasized that Jingxi requires 5-10 years' commitment in order to build up supply chain infrastructure and gain consumer mind share. The inflated scale expansion driven by short-term marketing expenses is not sustainable.
  - *4Q21:* Jingxi's revenue regained growth momentum at over 40% qoq in 4Q21, mainly led by Jingxi Pinpin, after concentrating resources in select cities in 3Q21; continued to emphasize improving UE.
  - *1Q22:* Jingxi further focused on a smaller number of select markets and improving UE model, resulting in moderation of revenue growth to 12% yoy, but a meaningful operating loss reduction qoq at ~Rmb1bn; efficiency and sustainable development are the priorities.

Alibaba:

- **User strategy:**
  - *4QF21:* S&M spending increased to drive user growth and engagement; strive to increase the user base and add new users.
  - *1QF22:* An important goal for Taobao Deals (TD) is to help increase the user base.
  - *2QF22:* Continued to invest in user acquisition amid challenging macro conditions.
  - *3QF22:* Focus shift from new user acquisition to user retention and ARPU growth; focus on strengthening user engagement and time spent.
  - *4QF22:* "China's Internet industry faces growth ceiling in user traffic and time spent."
- **New business strategy:**
  - *4QF21:* "It's important to continue to invest and build new businesses such as TD and Taocaicai (TCC)"; aggressively invested in TD.
  - *1QF22:* Investments in new strategic growth areas remain on target.
  - *2QF22:* Increased investment in strategic initiatives to increase consumer mind share and wallet share, and competing with peers that are also increasing investments to acquire users.
  - *3QF22:* Focus shift towards quality growth, and expect to gradually narrow the operating losses in these two businesses in the next few quarters through optimizing efficiency; executed several initiatives to optimize logistic costs.
  - *4QF22:* The combined loss of TD and TCC declined qoq, and is expected to continue to decline as Alibaba focuses on driving high-quality growth for its Chinese commerce segment.

Pinduoduo:

- **User strategy:**
  - *1Q21:* "So far we have been quite disciplined in our investment in Duo Duo Grocery," but will continue investing in logistics, infrastructure nad technology
  - *2Q21:* User base is approaching the ceiling, shift focus on serving existing users' evolving needs and strengthen mind share.
- **New business strategy:**
  - *3Q21:* Shift strategy towards R&D from S&M; focus on infrastructure investment of Duo Duo Grocery instead of aggressive user acquisition through subsidies.

Vipshop:

- **User strategy:**
  - *3Q21:* Have been investing in acquiring new users but found it not efficient, recently concentrated marketing dollars on existing and potential/inactive customers.
  - *4Q21:* Focused on converting high-profile users into SVIP.
  - *1Q22:* Gradually improved contribution from standardized products to improve user experience and ARPU.
- **Cost-saving strategy:**
  - *2Q21:* Had some control on overall marketing expenditure; aim to maintain the absolute level of S&M but not the S&M ratio.
  - *4Q21:* Prudent in marketing strategy and applied LTV model for all S&M channels to evaluate ROI; focused resources on selected brand partners.
  - *1Q22:* Implemented a number of cost-saving measures and scaled back a lot of low-ROI spending; will remain disciplined in cost savings and make sure gross and net margins are healthy in the coming quarters; focused on core brands.

Exhibit 20: New businesses – layoffs and scale-backs

Company	Date	Details: layoffs/scale-backs
JD - Jingxi/Jingxi Pinpin	May - Jul 2021	Exit Fujian, Gansu, Guizhou, Jilin, Ningxia, Qinghai and Shanxi, etc.
	Mar 2022	Layoff 10-15% of employees, including 400 employees in Jiangsu/Zhejiang regions
		Exit Sichuan, Jiangxi, Hainan, Guangdong, Jiangsu, Shanghai, leaving only Beijing, Shandong, Henan, Hubei
	Apr 2022	Layoff 100% of employees in Guangdong, Sichaun, Jiangxi
		Layoff 25% of employees in R&D department of Jingxi
	May 2022	Layoff 10-15% of employees (400-600 people) in Jingxi Business Group
		Exit other major regions except Hubei, Henan, Shandong and Beijing
	Jun 2022	Exit Jinan, Henan, Hubei, leaving Beijing and Zhengzhou
	Jul 2022	~100 employees from Jingxi Business Group will be transferred to the newly-established Same-city Business Group; the remaining 200+ Jingxi employees will seek to transfer to other departments, and they will be laid off if fell to transfer before the deadline of July 20th 2022.
		Richard Liu acknowledged the failure of Jingxi on JD Group's strategic meeting
PDD -Duo Duo Grocery	May 2022	Employees from Shanghai headquarters to different other regions were laid off or asked to return to Shanghai and wait for next steps
		To improve efficiency, Duo Duo Grocery merged pick-up points, shutted down inefficient community groups in areas like Guangzhou, Shanghai, Tianjin, Changchun, Quanzhou, etc. per users
Alibaba - Taocaicai	Nov 2021	Exit Guizhou
	Mar 2022	Layoff ~20% employees starting from 2022
Alibaba - Taobao Deals	May 2022	Layoff employees including at least 4 interns
Meituan - Meituan Select	Feb 2022	Layoff a significant portion of employees, but unclear about the amount
	Apr 2022	Kuailv, Meituan Maicai and Meituan Select layed off ~20% of employees
		Exit Gansu, Qinghai, Ningxia, Xinjiang.
		Exit Beijing

Source: NetEase, DoNews, 36Kr, The Economic Observer, TMTPost, Technode, Jiemian News, Sina Finance, China Business Network, Morgan Stanley Research

2. Focus more on cost control and margins – leading to better profitability (positive)

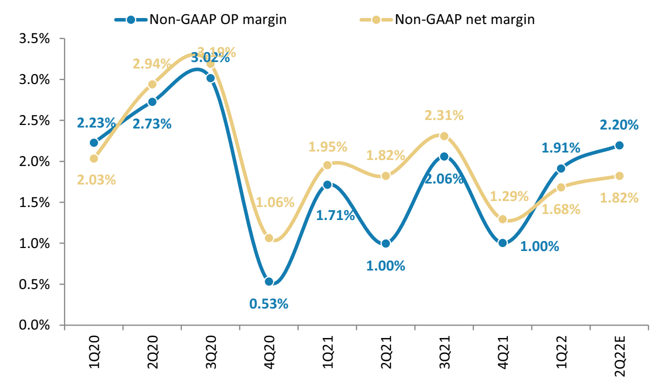
JD: JD's non-GAAP net margin dropped 1.1ppt yoy in 2Q21 with the commitment to speed up investment in CGB. Since 3Q21, JD started to reduce investments in CGB, and focused on improving efficiency/order density in selected provinces (10 provinces in 3Q21 vs. 20+ in 2Q21). We have seen more stabilized margins since 4Q21 thanks to continued investment/loss reduction in CGB, partly offset by the soft top-line growth amid weak consumption sentiment (Exhibit 21).

Alibaba: Alibaba's China Commerce non-GAAP EBITA margin sharply declined: 15.0ppt in 1QF22 and 18.6ppt yoy in 2QF22 with heavy strategic investments in strategic initiatives led by TD and TCC. Since 3QF22, Alibaba began to shift focus to user retention/ARPU growth and enhancing efficiency across business lines. Thus its China Commerce non-GAAP EBITA margin declined more moderately in 3Q-4QF22 (Exhibit 22).

Pinduoduo: Pinduoduo's non-GAAP net margin continued to improve with less drag from its loss-making 1P business and strategic shift from S&M to R&D in the past few quarters (Exhibit 23).

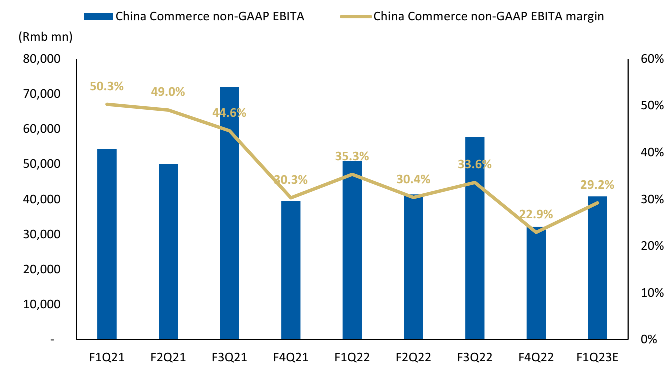
Vipshop: Vipshop's non-GAAP net margin was hurt by soft top-line growth, but we expect stabilized margins with its sustained stringent cost control measures (Exhibit 24).

Exhibit 21: JD – non-GAAP operating margins and net margins



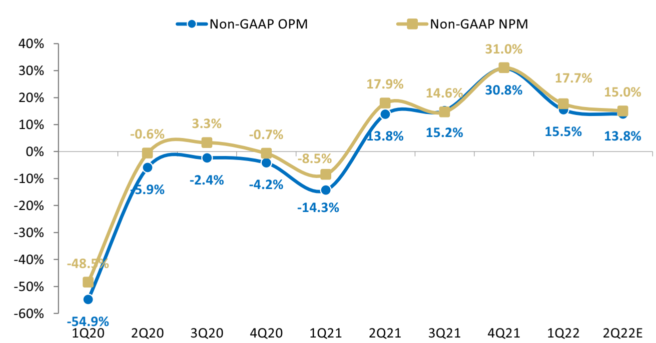
Source: Company data, Morgan Stanley Research Estimates (E)

Exhibit 22: Alibaba – China Commerce EBITA margins



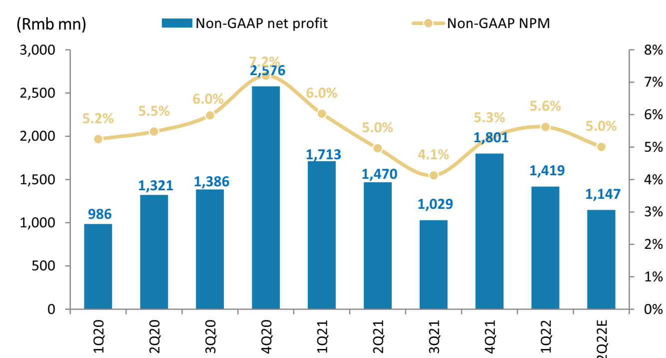
Source: Company data, Morgan Stanley Research Estimates (E)

Exhibit 23: Pinduoduo – non-GAAP operating margins and net margins



Source: Company data, Morgan Stanley Research Estimates (E)

Exhibit 24: Vipshop – non-GAAP net margins



Source: Company data, Morgan Stanley Research Estimates (E)

Negative impact: difficult to find meaningful new growth drivers, top-line growth inevitably to slow down

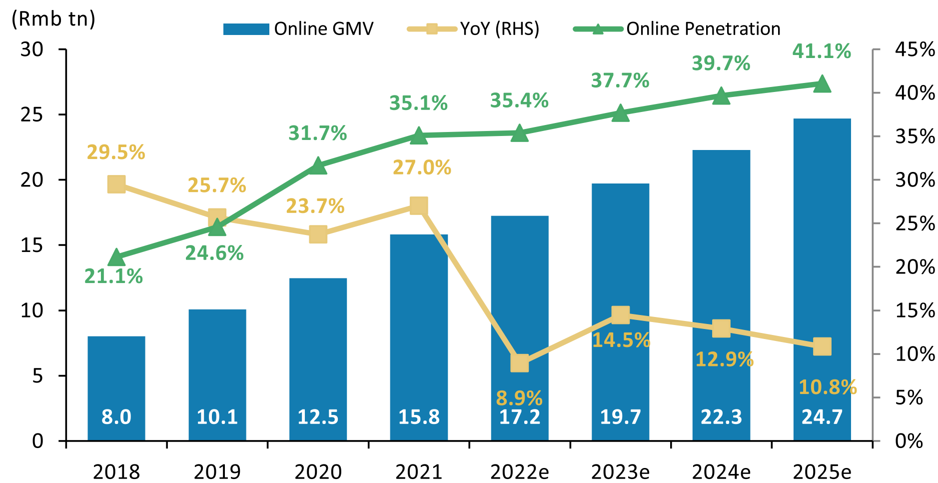
Various factors are making it more difficult for e-Commerce platforms to find meaningful new growth drivers:

- Stricter regulatory environment on antitrust and subsidies (thus making fast user acquisition more difficult),
- User growth/online penetration approaching ceiling, and
- Intense competition from live streaming e-Commerce players.

The inevitable result: top-line growth slowdown.

From our bottom-up analysis, we expect China's e-Commerce GMV growth to moderate to 8.5%, 14.9%, 12.9%, and 10.8% yoy in 2022, 2023, 2024, and 2025, respectively, from 20-30% yoy in 2018-21, driven by the above-mentioned factors (Exhibit 25).

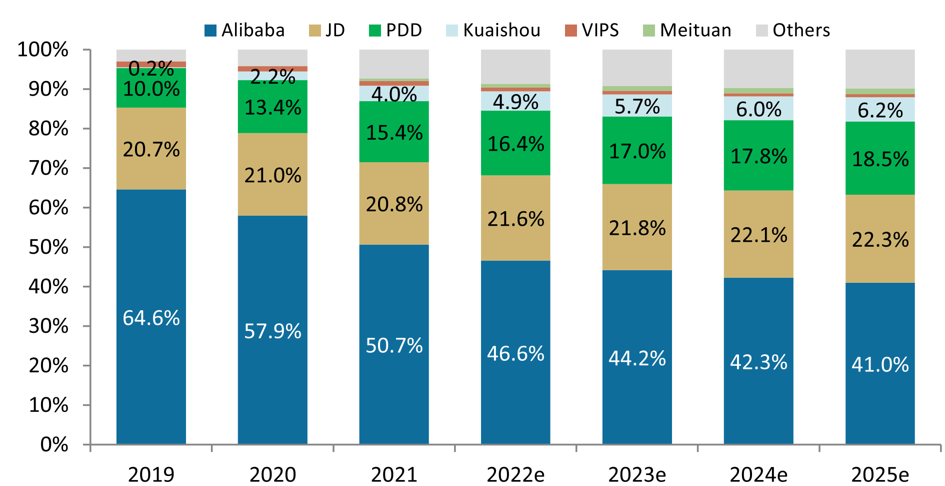
Exhibit 25: We expect China's e-Commerce GMV growth to moderate in 2022-24e



Source: Company data, Morgan Stanley Research Estimates (E)

Furthermore, we expect China's e-Commerce market to be more fragmented in the next few years, as live streaming e-Commerce platforms gain market share from traditional e-Commerce platforms. The combined market share for the top three players (Alibaba, JD, Pinduoduo) declined from 95.5% in 2018 to 86.9% in 2021, and we expect it to decrease further to 81.8% in 2025e (Exhibit 26).

Exhibit 26: We expect a continuous decentralization of China's e-Commerce market



Source: Company data, Morgan Stanley Research Estimates (E)

5. How to Invest in China's e-Commerce Market after Regulatory Reset

We believe the regulatory environment has entered a stable and easing stage. However, the e-Commerce market will slow down in the future because user growth is approaching the ceiling and because of the impacts from the regulatory reset during the past two years.

This will lead to structural changes in China's e-Commerce market and make it different from what it had experienced before Covid and regulatory reset. In this section, we discuss how to invest in China's e-Commerce market after regulatory reset from valuation and other financial metric angles.

A quick glance at key metrics of China's e-Commerce market – pre-Covid vs. post-Covid

We summarized key changes and investor concerns about the e-Commerce market pre-Covid vs. post-Covid in the table below. We select major e-Commerce platforms – Alibaba, JD, and Pinduoduo – to illustrate the trends in the market.

GMV: We expect GMV growth for the whole e-Commerce market to slow down in the next few years because user growth is approaching the ceiling and major categories are already highly penetrated. Per NBS, online retail sales of goods posted a 24% CAGR over 2016-19, pre-Covid. We forecast major e-Commerce platforms' GMV CAGR to moderate to 8-13% over 2023-26e (JD at 9%, Alibaba at 7%, Pinduoduo at 15%), and the market GMV CAGR at 11% over the same period, according to our bottom-up GMV analysis (Exhibit 32). This is largely consistent with Visible Alpha consensus forecast at 7-14% CAGR for 2023-26e, and what China's 14th five-year development plan indicated.

Non-GAAP net profit: We select Alibaba as a representative for the pre-Covid level e-Commerce market performance, given that it held market share of 65-80% and was consistently profitable – its non-GAAP net profit recorded a 33% CAGR over 2016-19. After Covid, we expect the market to generate a 19-30% CAGR over 2023-26e (JD at 25%, Alibaba at 19%, Pinduoduo at 30%), largely similar to Visible Alpha's consensus at 17-29%. We believe improvement in non-GAAP net profit growth is driven by improving margins amid a more rational competitive environments and platforms being more prudent in user acquisitions and new businesses investments.

ROE: Taking Alibaba as representative for the pre-Covid period, its ROE was 23-27% during 2016-19. During 2023-26e, we expect the segment ROE to be 11-25% (JD at 11-15%, Alibaba at 13-14%, Pinduoduo at 24-25%). Improving margins vs. pre-Covid level for Pinduoduo and JD support growth in ROE. On the other hand, Alibaba's declining margins hurt its ROE.

Non-GAAP P/E (12-month forward): During 2016-19, BABA mostly traded at 17-35x 12-month forward non-GAAP P/E and JD at 19-26x.

International revenues: International/cross-border commerce has not been a key focus area for major e-Commerce platforms in China – Alibaba has been the most dedicated to international commerce vs. other players. Given intensified competition and reducing investments to protect margins, we expect Alibaba's international commerce revenue CAGR to decline from 36% during 2016-19 to 21% in 2023-26e.

	Pre-Covid (2016-19)	Post-Covid MSe (2023-26e)	Post-Covid Consensus (2023-26e)	What's Priced In?
GMV three-year CAGR	24% (online retail sales of goods, per NBS)	8-13%	7-14%	1. Overall consumption could slow down along with the economy's slowdown in the next five years. 2. User growth is approaching ceiling and some categories are already highly penetrated.
Non-GAAP net profit three-year CAGR	33% (Alibaba)	19-30%	17-29%	1. Lower investment level vs. 2020-21 – a regulatory environment discouraging disorderly expansion could lead to improving margins and profitability. 2. However, involutionary competition from live streaming e-Commerce could drag down profit growth for the whole market, led by Alibaba.
ROE	23-27% (Alibaba)	11-25%	13-25%	1. Improving margins and above-segment growth of both JD and Pinduoduo enable them to achieve improving ROE. However, ROE level of leading e-Commerce platforms should be lower than Alibaba's pre-Covid ROE level, when it was the proxy for e-Commerce market, faced less competition, and enjoyed higher industry growth – and hence, higher ROE.
12-month forward non-GAAP P/E	BABA: 17-35x JD: 19-26x PDD: N/A	BABA: 15-20x JD: 25-33x (1-1.4x PEG) PDD: 20-30x (0.8-1.2x PEG)	BABA: 10-15x JD: 20-30x (0.8-1.2x PEG) PDD: 20-30x (0.8-1.2x PEG)	1. e-Commerce players that are expected record a slower growth vs. segment average will have a lower P/E multiple in the next five years. 2. e-Commerce players that are able to grow faster than the segment average will enjoy a higher multiple than before. 3. Visibility of growth is lower than before.
International revenue	Only Alibaba has relatively meaningful exposure to international e-Commerce.	Only Alibaba will continue to have meaningful exposure to international e-Commerce.		Only Alibaba will continue to have meaningful exposure to international e-Commerce.

Pinduoduo and JD to record above-segment GMV growth; Alibaba and Vipshop to generate below-segment GMV growth

As discussed before, we believe China's e-Commerce market growth would slow down in the next few years with user and online penetration approaching the ceiling, and disruptions from live streaming e-Commerce players.

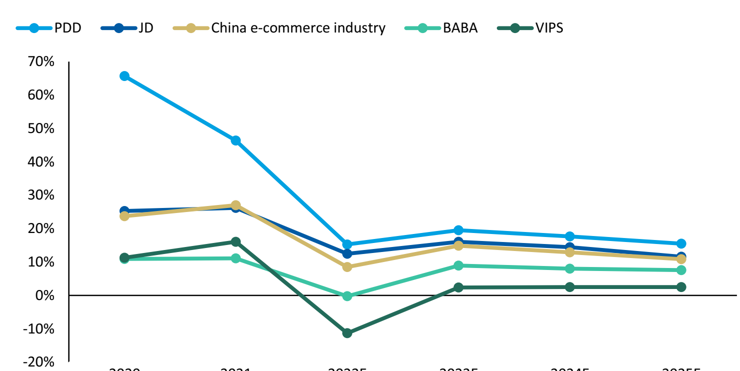
However, we see Pinduoduo and JD as outperformers in the market with above-segment revenue growth in 2022-25e, and we expect them to gain market share.

- We expect *Pinduoduo* to onboard more branded merchants, backed by its market-leading user and GMV base, potentially driving up ARPU and monetization in the long term.
- *JD* is less disrupted by live streaming platforms given its unique supply chain-based 1P model and core categories being 3C/home appliances, in which we believe live streaming would not be able take a meaningful wallet share. Besides, we expect it to onboard more 3P merchants to enrich its product offerings, driving user growth and ARPU improvement.

On the other hand, we forecast Alibaba and Vipshop to record below-segment growth. Their category focus on apparel makes them more vulnerable to live streaming disruptions. (Exhibit 27)

This translates into 2022-25e revenue CAGRs of 18.3% and 12.9% for Pinduoduo OMS and JD respectively, beating Alibaba China Commerce and Vipshop's 9.8% and 1.7% revenue CAGRs over the same period (Exhibit 28).

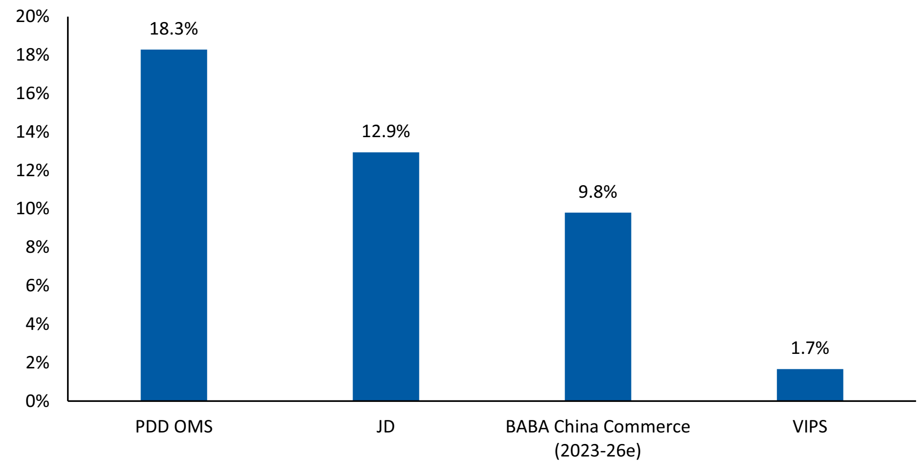
Exhibit 27: China's e-Commerce GMV growth (yoy)



	2020	2021	2022E	2023E	2024E	2025E
PDD	65.7%	46.4%	15.3%	19.5%	17.6%	15.5%
JD	25.3%	26.2%	12.4%	16.0%	14.5%	11.6%
China e-commerce industry	23.7%	27.0%	8.5%	14.9%	12.9%	10.8%
BABA	10.9%	11.1%	-0.2%	9.0%	8.0%	7.6%
VIPS	11.3%	16.1%	-11.3%	2.4%	2.5%	2.5%

Source: Company data, Morgan Stanley Research (E) Estimates

Exhibit 28: China's e-Commerce revenue CAGR over 2022-25e



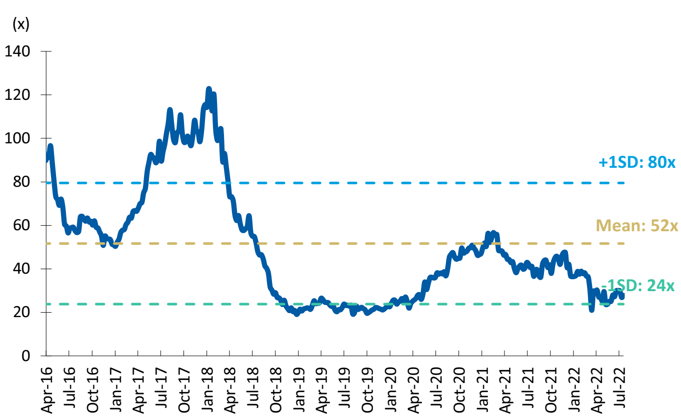
Source: Company data, Morgan Stanley Research (e) Estimates

P/E valuation to diverge on different growth levels

Because growth is still the key area of investor focus in China's e-Commerce segment and the whole Internet industry, growth moderation would inevitably affect companies' valuation level. Our P/E band analysis shows that major e-Commerce platforms are now trading at a discount vs. previous levels during high growth phases. This is partly because of the regulatory reset in the past two years.

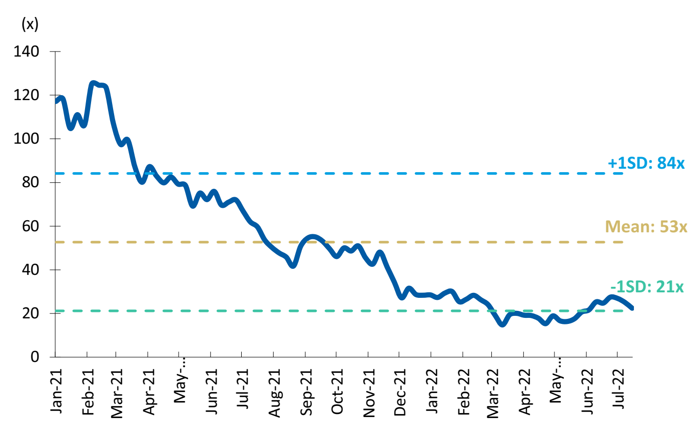
We expect the e-Commerce platforms that are able to achieve above-segment growth would command a premium valuation. Platforms growing more slowly than the segment would be subject to a discounted valuation.

Exhibit 29: JD: 12-month forward P/E band



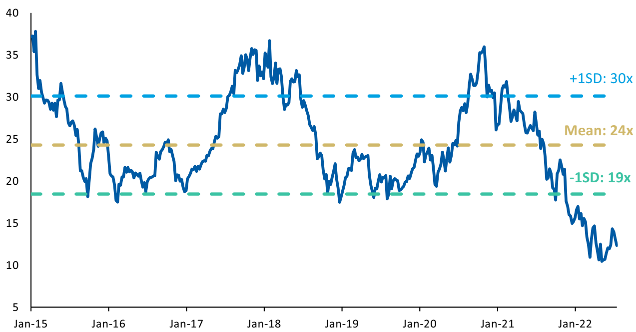
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 18th 2022

Exhibit 30: PDD: 12-month forward P/E band



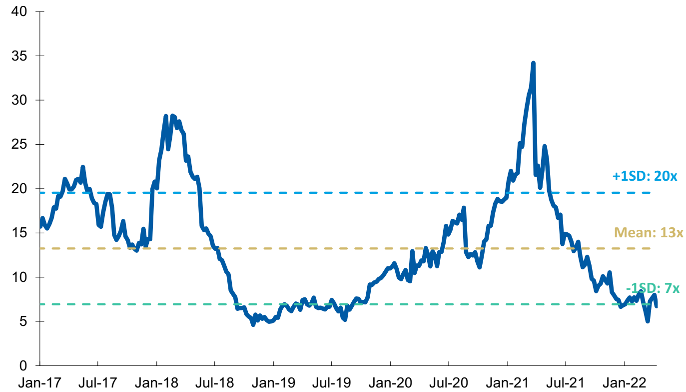
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 22th 2022

Exhibit 31: BABA: 12-month forward P/E band



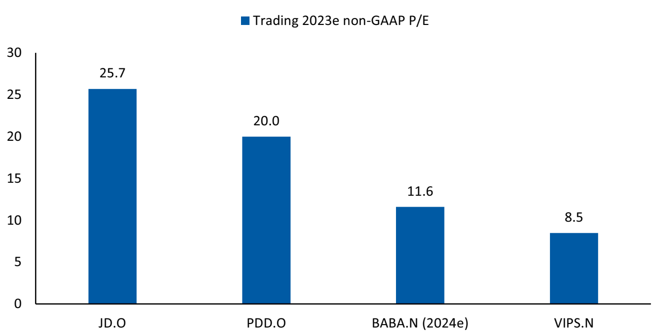
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 18th 2022

Exhibit 32: VIPS: 12-month forward P/E band



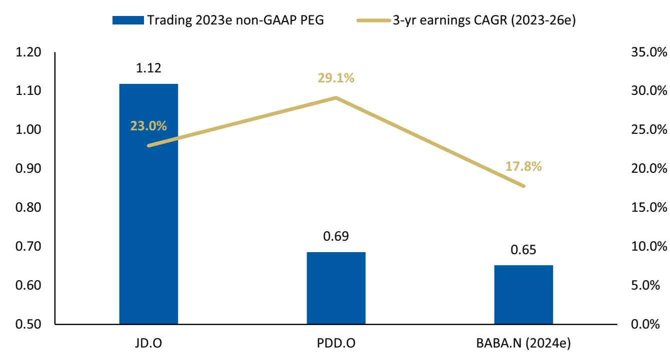
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 18th 2022

Exhibit 33: 2023e non-GAAP P/E



Source: Refinitiv Eikon, Company data, Morgan Stanley Research Estimates, Note: price as of July 20th 2022

Exhibit 34: 2023e non-GAAP PEG



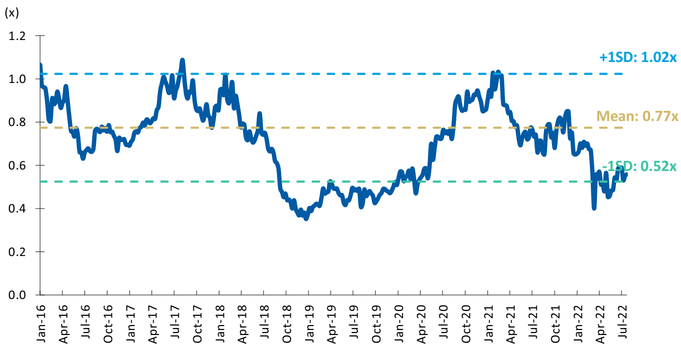
Source: Refinitiv Eikon, Company data, Morgan Stanley Research Estimates, Note: price as of July 20th 2022

Other valuation multiples

We also analyze major e-Commerce platforms' 12-month forward P/S ratio to provide another valuation angle. Similar to what our P/E band analysis shows, all major players are now trading at a level that is equal or more than one standard deviation below their historical average P/S ratio.

Investors have always been valuing JD, BABA and VIPS by P/E multiples rather than P/S, because they have earned stable net profits over the years. In recent quarters, Pinduoduo's improving profitability backed by cost control triggered investors to shift their valuation angle from P/S to P/E. We expect sustainable margin improvement should support such a multiple shift in future.

Exhibit 35: JD: 12-month forward P/S band

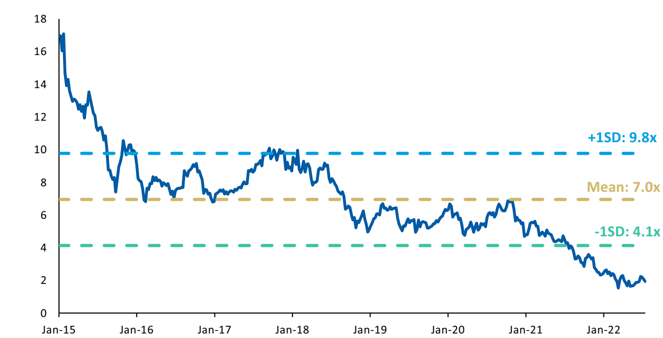


Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 25th 2022

Exhibit 36: PDD: 12-month forward P/S band

Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 22th 2022

Exhibit 37: BABA: 12-month forward P/S band



Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 25th 2022

Exhibit 38: VIPS: 12-month forward P/S band

Source: Refinitiv Eikon, Company data, Morgan Stanley Research Note: data as of Jul 25th 2022

Benchmarking with global peers

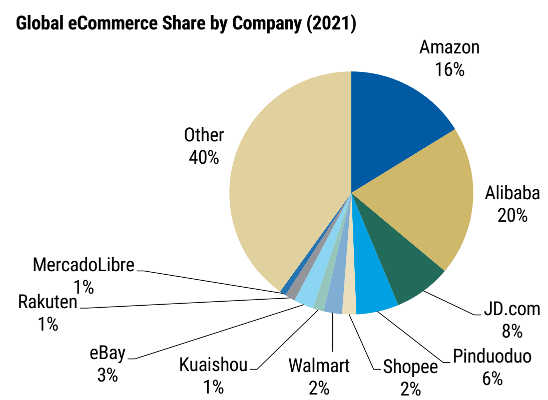
1. China's e-Commerce market – leading in size and penetration

China's e-Commerce market is leading the global e-Commerce market in both size and penetration, thanks to the massive online population, continuous trend of rapid urbanization and consumption upgrades, and early stage of development of e-Commerce businesses. In 2021, China held a 37% share of the global e-Commerce market share (Exhibit 39) with Alibaba, JD, and PDD combined accounting for 34% of the global e-Commerce market (Exhibit 40). We forecast a 10.2% CAGR (in CNY terms) in 2021-26e for China's e-Commerce GMV (vs. 23.4% for 2016-21). Per Euromonitor, e-Commerce penetration in China rose from 13.1% in 2016 to 28.5% in 2021, above the global average e-Commerce penetration of 21% in 2021. We see China's e-Commerce penetration reaching 35% in 2026e.

Exhibit 39: Global e-Commerce share by market (2021)

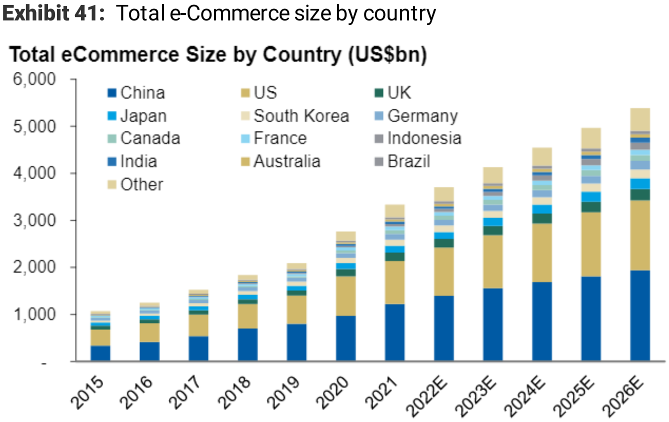
Source: Euromonitor, National Data Sources, Morgan Stanley Research estimates

Exhibit 40: Global e-Commerce share by company (2021)



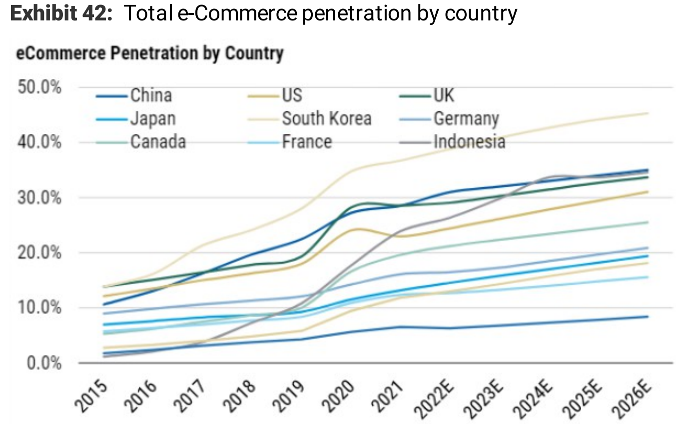
Source: Company data, Morgan Stanley Research estimates

Exhibit 41: Total e-Commerce size by country



Source: Euromonitor, National Data Sources, Morgan Stanley Research (E) estimates

Exhibit 42: Total e-Commerce penetration by country



Source: Euromonitor, National Data Sources, Morgan Stanley Research (E) estimates

Region/Country	2021 e-Commerce Penetration	2026e e-Commerce Penetration	Key Drivers and Differentiators
South Korea	37%	45%	South Korea is the market with highest penetration, supported by well-developed payments and infrastructure logistics. Consumers have rapidly migrated to e-Commerce, appreciating convenience and price transparency. Further growth drivers include food categories and last-mile delivery.
China	29%	35%	Already a leading market by size and penetration, we see the next leg of China's e-Commerce growth being driven by underpenetrated categories (FMCG, grocery) and increasing time spent (live-streaming e-Commerce).
North America	23%	31%	The Covid-driven e-Commerce pull-forward is unlikely to reverse in the US, with broadening adoption (including grocery), delivery convenience (<2-day prevalence), and structural changes to the brick-and-mortar supply (store closures).
Australia	19%	25%	We see top-down retail sales support from a high household savings rate, with e-Commerce growth drivers of Covid-driven behavioral change, aggressive investments by omni-channel retailers, and logistics operators' capacity increases.
Southeast Asia	19%	29%	ASEAN e-Commerce is among the fastest-growing major regions. Relatively lower penetration, a broadening category base, a company-driven investment cycle, and third-party logistics expansion are tailwinds, while Covid-related disruption was a catalyst for adoption.
Western Europe	17%	21%	The UK leads within the region for e-Commerce size and penetration, driving slower forecast growth, including in the apparel category. The opportunity in Spain and Italy is relatively earlier-stage, but overall we see Western Europe among the slower-growth e-Commerce markets.
Eastern Europe	17%	25%	Looking to both Poland and Turkey, the markets remain underpenetrated versus the global average. In Poland, we highlight increasing spending per customer as an opportunity, while Turkey could benefit more directly from a young and growing population.
Japan	13%	19%	In Japan, e-Commerce penetration is below levels in other developed markets, owing in part to urban density and physical store convenience. However, Covid disruption has spurred greater online adoption, and growth appears particularly promising in the food/beverages category.
Latin America	11%	20%	With a young and digitalized population, the shift to mobile Internet has been an e-Commerce catalyst in LatAm. Logistical infrastructure in the region remains a barrier, but we see investments by omni-channel and marketplace operators driving rapid improvements.
India	6.5%	8.4%	India's young, aspirational, and Internet-connected consumer cohort can drive e-Commerce adoption, and companies are investing behind omni-channel. However, a large unorganized retail segment could keep e-Commerce penetration lower than in other developed countries.
Africa	2.8%	5.7%	Africa's e-Commerce remains nascent, and we see structural support from a young and mobile-savvy population, plus a growing middle class. However, significant barriers to growth remain, including poor infrastructure and a lack of established address systems/logistics networks.

2. China's e-Commerce group – valuation

Our global e-Commerce comp sheet shows that Pinduoduo is trading well above global average on 2022e and 2023e EV/sales and EV/EBITDA multiples, supported by stronger revenue growth (30% CAGR over 2020-23e vs. global average at 22%). Pinduoduo's 2022e and 2023e EV/sales are 3.9x and 3.2x (vs. the global averages at 1.8x and 1.5x). Its 2022e and 2023e EV/EBITDA multiples are 32.7x and 19.9x (vs. the global averages at 18.5x and 15.7x).

Alibaba is trading fairly similar to global averages for EV/sales multiples at 1.7x and 1.6x for 2022e and 2023e (vs. the global averages at 1.8x and 1.5x). However, it is trading at a discount for EV/EBITDA multiples at 12.0x and 9.5x (vs. the global averages at 18.5x and 15.7x), reflecting slower EBITDA growth at 9% CAGR over 2020-23e (vs. the global average at 18%).

JD is trading at a lower EV/sales multiple compared to Pinduoduo and Alibaba and most of its global peers, because it operates a 1P model (~50% of GMV for JD is 1P) and thus has greater revenue – JD is trading at 0.5x and 0.4x 2022e and 2023e EV/sales.

Exhibit 43: Global e-Commerce Comps – EMEA & APAC

Company	Country	MS Rating	Last Price	Price Target	Upside/ Downs.	Market Cap ($mn)	EV ($mn)	ADTV ($mn)	EV/Revenue		CAGR 20-23e	EV/Rev. to '21-'24 CAGR	EV/EBITDA		CAGR 20-23e
									2022	2023			2022	2023	
EMEA eCommerce															
Zalando SE	Germany	EW	26	34	29%	7,140	6,412	59	0.6x	0.5x	13%	0.07x	17.0x	11.4x	-2%
Allegro.eu SA	Poland	EW	24	29	22%	5,237	5,972	20	3.0x	2.4x	43%	0.06x	13.4x	12.1x	13%
ABOUT YOU Holding SE	Germany	NC	8	NC	NA	1,457	1,411	3	0.8x	0.6x	NA	NA	NM	NM	NM
ASOS PLC	United Kingdom	EW	1,035	1,400	35%	1,319	1,475	13	0.3x	0.3x	11%	0.04x	8.2x	4.6x	0%
Boohoo Group PLC	United Kingdom	UW	66	67	1%	1,018	687	10	0.3x	0.3x	18%	0.03x	5.1x	6.6x	-11%
Jumia Technologies AG	United Kingdom	UW	5	5	-7%	523	410	6	1.7x	1.5x	20%	0.07x	NM	NM	NM
Boozt AB	Sweden	NC	69	NC	NA	442	355	2	0.5x	0.5x	22%	0.03x	7.8x	6.2x	11%
Global Fashion Group	Luxembourg	EW	1	NA	NA	292	55	1	0.0x	0.0x	7%	0.00x	NM	60.9x	-16%
Hepsiburada	Turkey	EW	1	NA	NA	290	73	1	0.1x	0.1x	45%	0.00x	NM	NM	NM
MADE.com Group Plc	United Kingdom	EW	13	61	378%	54	NM	1	-0.1x	-0.1x	16%	NM	2.2x	NM	53%
Westwing Group SE	Germany	NC	6	NC	NA	138	96	1	0.2x	0.2x	6%	0.04x	NM	3.5x	-17%
EMEA Median									**0.3x**	**0.3x**	**17%**	**0.04x**	**8.0x**	**6.6x**	**-1%**
APAC eCommerce															
Alibaba Group Holding	China	OW	103	140	36%	268,256	220,016	389	1.7x	1.6x	22%	0.12x	12.0x	9.5x	9%
Meituan	China	OW	190	240	26%	145,416	134,163	650	4.3x	3.0x	39%	0.10x	NM	38.1x	36%
JD.com, Inc.	China	OW	63	80	26%	98,779	81,991	657	0.5x	0.4x	18%	0.03x	26.9x	18.9x	9%
Pinduoduo	China	EW	55	70	27%	75,069	63,127	620	3.9x	3.2x	30%	0.17x	32.7x	19.9x	NM
Sea Ltd	Singapore	OW	77	128	66%	48,542	38,509	130	3.0x	2.4x	43%	0.09x	NM	NM	NM
Naver Corp	S. Korea	EW	246,000	260,000	6%	30,806	30,978	137	5.1x	4.4x	20%	0.30x	23.1x	20.7x	8%
Coupang Inc	S. Korea	OW	17	18	6%	29,927	27,072	146	1.3x	1.1x	28%	0.07x	NM	NM	NM
Z Holdings	Japan	OW	440	800	82%	24,410	18,311	71	1.5x	1.3x	16%	0.15x	7.6x	6.3x	14%
FSN E-Commerce Ventures Ltd	India	OW	1,436	1,845	29%	8,505	8,498	10	18.3x	12.3x	46%	0.27x	NM	NM	60%
MonotaRO	Japan	EW	2,279	2,500	10%	8,249	8,237	34	4.9x	4.1x	20%	0.23x	37.7x	29.2x	22%
Rakuten Group Inc	Japan	EW	635	700	10%	7,392	160	87	0.0x	0.0x	14%	0.00x	NM	0.1x	47%
Vipshop Holdings Ltd	China	EW	10	10	2%	6,864	4,145	17	0.3x	0.3x	0%	NM	4.2x	4.0x	0%
ZOZO	Japan	EW	2,842	3,300	16%	6,263	5,781	31	4.3x	4.0x	10%	0.46x	14.1x	13.0x	9%
Mercari	Japan	EW	2,155	2,500	16%	2,542	2,528	141	2.3x	2.1x	30%	0.10x	NM	NM	NM
Temple & Webster Group Ltd	Australia	OW	4	6	50%	360	292	2	1.0x	0.8x	44%	0.03x	38.8x	41.0x	7%
Kogan.com Ltd	Australia	NC	3	NC	NA	232	234	2	0.4x	0.4x	14%	0.41x	15.9x	8.6x	-7%
Redbubble Ltd	Australia	EW	1	1	6%	181	113	1	0.3x	0.3x	18%	0.04x	NM	NM	-15%
Adore Beauty Group Limited	Australia	OW	1	2	48%	82	62	0	0.5x	0.4x	23%	0.03x	19.2x	13.2x	12%
APAC Median									**1.6x**	**1.5x**	**21%**	**0.10x**	**19.2x**	**13.2x**	**9%**
Global Average									**1.8x**	**1.5x**	**22%**	**0.12x**	**18.5x**	**15.7x**	**18%**
Global Median									**0.7x**	**0.6x**	**20%**	**0.07x**	**14.4x**	**11.9x**	**9%**
Global 75th Percentile									**2.5x**	**2.1x**	**30%**	**0.11x**	**28.1x**	**20.3x**	**22%**
Global 25th Percentile									**0.3x**	**0.3x**	**15%**	**0.03x**	**7.8x**	**6.3x**	**0%**

Source: Refinitiv Eikon, Company data, Morgan Stanley Research estimates, except for non-covered companies (NC), which are consensus estimates.Note: Pricing as of 7/27/2022.

Exhibit 44: Global e-Commerce Comps – Americas

Company	Country	MS Rating	Last Price	Price Target	Upside/ Downs.	Market Cap ($mn)	EV ($mn)	ADTV ($mn)	EV/Revenue		CAGR 20-23e	EV/Rev. to '21-'24 CAGR	EV/EBITDA		CAGR 20-23e
									2022	2023			2022	2023	
LatAm eCommerce															
Mercadolibre Inc.	Argentina	OW	792	1,480	87%	39,378	38,354	587	3.7x	3.0x	48%	0.10x	34.3x	21.3x	98%
Magazine Luiza S.A.	Brazil	EW	2.7	6.5	141%	3,212	3,698	137	0.5x	0.4x	16%	0.03x	12.8x	8.6x	33%
Americanas S.A.	Brazil	EW	15.5	31.0	101%	2,529	3,513	52	0.6x	0.5x	19%	0.04x	6.2x	5.1x	15%
Via S.A.	Brazil	UW	2.5	3.5	41%	720	1,232	32	0.2x	0.2x	9%	0.02x	4.6x	4.2x	3%
Mobly S.A.	Brazil	EW	2.3	6.0	161%	45	NM	1	0.0x	0.0x	28%	NM	NM	NM	137%
Westwing Brazil	Brazil	NC	2.2	NC	NA	45	1	0	0.0x	0.0x	23%	0.00x	NM	0.4x	5%
LatAm Median									**0.4x**	**0.3x**	**21%**	**0.03x**	**9.5x**	**5.1x**	**24%**
US eCommerce															
Amazon.com Inc	United States	OW	121	175	45%	1,231,475	1,184,170	10,165	2.3x	2.0x	16%	0.14x	15.9x	12.3x	19%
eBay Inc	United States	UW	47	36	-24%	26,940	28,699	329	3.1x	3.1x	2%	NM	11.0x	11.4x	-8%
Chewy Inc	United States	EW	39	42	8%	16,359	15,756	36	1.5x	1.3x	19%	0.09x	NM	NM	NM
Etsy Inc	United States	EW	96	83	-13%	13,913	15,314	432	6.2x	5.8x	15%	0.78x	37.4x	37.8x	-6%
Wayfair Inc	United States	UW	50	70	40%	5,244	6,789	48	0.5x	0.5x	1%	0.07x	NM	NM	NM
Farfetch Ltd.	United States	OW	8	30	268%	3,804	3,039	20	1.2x	0.9x	25%	0.04x	3.3x	17.5x	NM
Revolve Group Inc	United States	EW	27	51	89%	2,026	1,807	11	1.6x	1.3x	33%	0.06x	14.8x	11.7x	33%
FIGS, Inc.	United States	EW	10	12	23%	1,803	1,606	15	3.1x	2.4x	36%	0.10x	31.9x	24.4x	4%
Mytheresa	United States	EW	13	14	9%	1,107	1,030	0	1.5x	1.3x	22%	0.07x	59.2x	20.2x	22%
Poshmark Inc	United States	EW	10	17	66%	794	213	14	0.6x	0.5x	18%	0.03x	NM	NM	NM
Stitch Fix Inc	United States	EW	6	5	-16%	651	419	35	0.2x	0.2x	5%	0.42x	NM	NM	NM
RealReal Inc	United States	EW	2	10	315%	225	155	23	0.2x	0.2x	40%	0.01x	NM	NM	NM
ThredUp Inc.	United States	EW	2	9	348%	198	149	8	0.5x	0.4x	29%	0.01x	NM	NM	NM
US Median									**1.5x**	**1.3x**	**19%**	**0.07x**	**15.9x**	**17.5x**	**11%**
Global Average									**1.8x**	**1.5x**	**22%**	**0.12x**	**18.5x**	**15.7x**	**18%**
Global Median									**0.7x**	**0.6x**	**20%**	**0.07x**	**14.4x**	**11.9x**	**9%**
Global 75th Percentile									**2.5x**	**2.1x**	**30%**	**0.11x**	**28.1x**	**20.3x**	**22%**
Global 25th Percentile									**0.3x**	**0.3x**	**15%**	**0.03x**	**7.8x**	**6.3x**	**0%**

Source: Refinitiv Eikon, Company data, Morgan Stanley Research estimates, except for non-covered companies (NC), which are consensus estimates.Note: Pricing as of 7/27/2022.

Valuation Methodology and Risks

Alibaba Group Holding (BABA.N)

Base case, discounted cash flow model. Key assumptions include 11% WACC (in line with Tencent), and 3% terminal growth rate, in line with our Chinese Internet coverage range.

Risks to Upside

- Better core e-commerce monetization drives earnings growth upside.
- Faster enterprise digitalization re-accelerates cloud revenue growth.
- Cloud margin expansion is stronger.

Risks to Downside

- Intensified competition in less-developed regions would slow down GMV growth and pose downside to margins.
- Lingering macro headwinds may pressure discretionary spending in China and affect our GMV and earnings forecasts.

JD.com, Inc. (JD.O)

Base case scenario value, derived from a discounted cash flow valuation, which is our preferred methodology because it incorporates our long-term view of the company's operations. In our DCF model, we apply a 13% WACC and a 3% terminal growth rate.

Risks to Upside

- Faster-than-expected margin expansion from operating leverage
- Faster-than-expected growth in FMCG e-commerce and home appliances
- Successful penetration in lower-tier cities, driving up user growth

Risks to Downside

- Longer-than-expected Omicron impact
- Longer-than-expected recovery of consumption sentiment
- Possible return of irrational competition in e-commerce

Pinduoduo (PDD.O)

Base case, derived from our DCF model. Key assumptions include a WACC of 14%, in line with the average within our Chinese Internet coverage, and a terminal growth rate of 3%, also in line with those companies.

Risks to Upside

- User growth is faster than expected, energized by the upcoming consumption downgrade.
- Online grocery growth is faster than expected, with better-than-expected unit economics.
- Less intense competition leads to lower opex.

Risks to Downside

- Intensified competition weighs on margin improvement.
- User engagement level drops when subsidy level normalizes.
- More stringent regulatory environment could also weigh on margins.

Vipshop Holdings Ltd (VIPS.N)

Base case, derived from our DCF valuation in which we assume a 14.0% WACC and a 3% terminal growth rate.

Risks to Upside

- Improved consumption sentiment and apparel demand.
- More de-stocking demand from apparel companies.
- Potential share repurchase program and dividend payout plan.

Risks to Downside

- Active customer growth slowdown.
- Heightened spending that hampers margin expansion trajectory.
- Intensifying competition, pressuring margins.
- Growth deceleration, prompting de-rating.