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CMB International Global Markets | Equity Research | Sector Update

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# Internet

## 2Q24 recap & stock-picking ideas: Seeking certainty

We update our sector investment views for the next six months post earnings as follows: 1) Companies with solid fundamentals and high revenue and profit growth visibility; 2) sustained profitability and willingness to lift shareholder returns; and 3) a sizeable TAM for new initiatives and business explorations likely to generate a decent ROIC. We believe the market will continue to allocate to such names and value them fairly. Taking into account 2Q results and recent stock performances, we find our previous view has been testified: better-than-expected earnings are not enough to drive a share rally, but better-than-expected 3Q/full-year outlook and enhanced shareholder return measures could provide key support. With the market now seeking certainty over growth, we recommend 1) companies with improving fundamentals and poised to see incremental funds following Stock Connect inclusion, such as Alibaba (BABA US); 2) fundamentals are resilient and full-year outlook has strengthened, such as Meituan (3690 HK) and Trip.com (TCOM US); 3) core business enjoys a stable competitive landscape and fundamentals are robust, with willingness to raise shareholder returns, such as Tencent (700 HK); 4) Bilibili (BILI US) which stands to benefit from new game launches; and 5) Pinduoduo (PDD US), which now we see as undervalued vs. its earnings growth potential, with new growth drivers to bring more upside.

- **2Q recap: Refined operation helped bolster profits amid macro headwinds**. Marketplaces (for ecommerce, local life services, OTA) posted impressive profits backed by optimized supply to meet consumers' value for money and quality demand and experience requirements, with tiered user operation lifting purchasing frequency of core users, and refined operation and subsidy cuts easing competition. Online advertising platforms' resilient revenue and profit growth was attributable to increasing commercialization efficiency (through algorithm optimization etc.) and rising ad load. Online music platforms' solid earnings growth was due to increasing paying ratios and ARPPU, as well as operational leverage. While the market has begun trading on the Fed's rate cuts, we believe investors collecting internet names could still focus on earnings rather than liquidity, and that long-term recovery of consumption with dwindling property-related risks is key to a valuation rebound in the mid- to long-term. From a short-term perspective, consumption stimulus and their actual impact may shift investor preference from high-certainty names to growth ones.

- **2H24 outlook: Seeking certainty.** Fundamental-wise, we like local life services (competition easing, share rally likely to persist backed by fundamentals), online games (still bottoming in 1H24 but recovery expected in 2H driven by new products) and OTA (domestic travel demand resilient, outbound business recovering). E-commerce has been weighed down by weak retail sales of consumer goods, but players are making incremental investments under high ROI targets or focusing mainly on international expansion, so concerns over a deteriorating domestic landscape may be overdone. For online advertising, we see divergent performances across platforms. Medium- and short-video platforms' ad revenue growth should stay resilient, but traditional social network services or search platforms may face pressure, with advertisers' budgets tilted towards major players providing high-ROI solutions.

- **Attractive and sustainable shareholder returns to buoy valuation.** Chinese internet companies' average net cash/market cap ratio has reached 31.8% (Fig. 2). As their core business matures, rewarding shareholders with attractive and sustainable returns may prompt the market to re-assess the value of net cash on the books and support valuation, apart from new business initiatives. The sustainability derives from a stable competitive landscape for core business and solid growth prospects. We prefer Alibaba and Tencent under the theme of enhanced shareholder return.

**OUTPERFORM**
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17. Beike (BEKE US) - Solid market share gains amid uncertain environment – 13 Aug
18. 互联网 - 1Q24 行业业绩总结及三条投资布局主线 – 19 Jun

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## Internet stock-picking ideas update

For 2H24, considering the industry climate, company fundamentals and valuations, our pecking order for the internet sector is as follows. 1) Alibaba: monetization is improving apparently, margins will likely be supported by better operational efficiency of new business, and incremental funds may be drawn after joining the Stock Connect. 2) Meituan: Competition has further softened, the profitability of the community business has continued to optimize, and other new businesses have entered a phase of stable profitability, underpinning fundamental resilience and a valuation re-rating. 3) Trip.com: The company is poised to see resilient earnings and better-than-peers' long-term growth prospects backed by its sticky core user base and strong outbound travel business, which benefits from a leading business presence and has recovered more rapidly than the overall industry. 4) Tencent: Its core business enjoys a stable competitive landscape, and high-gross-margin businesses (games/Video Accounts advertising & live streaming e-commerce) have been driving steady profit growth, supporting a high level of shareholder returns. 5) Bilibili: With the launch of new games, revenue growth has accelerated and profitability improved, and its earnings may beat expectations in the short term. 6) Pinduoduo: The stock may have been over-punished considering its earnings growth potential, and new growth drivers look promising.

**Figure 1: Internet: rating of sub-sector fundamentals**

| Subsector | Potential for online penetration | Revenue growth | Earnings growth | Growth certainty | Competitive landscape | Earnings resilience | Shareholder return |
|---|---|---|---|---|---|---|---|
| Local life services | ★★★☆☆ | ★★★☆☆ | ★★★★☆ | ★★★★☆ | ★★★☆☆ | ★★★☆☆ | ★★☆☆☆ |
| Online music | ★☆☆☆☆ | ★★★☆☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★☆☆☆ |
| OTA | ★★☆☆☆ | ★★☆☆☆ | ★★☆☆☆ | ★★★★☆ | ★★★★☆ | ★★★☆☆ | ★☆☆☆☆ |
| Games | ★☆☆☆☆ | ★★☆☆☆ | ★★★☆☆ | ★★★★☆ | ★★★☆☆ | ★★★★☆ | ★★★☆☆ |
| E-commerce | ★☆☆☆☆ | ★☆☆☆☆ | ★☆☆☆☆ | ★★★☆☆ | ★★☆☆☆ | ★★☆☆☆ | ★★★★☆ |
| Online ads | ★☆☆☆☆ | ★★☆☆☆ | ★★☆☆☆ | ★★★☆☆ | ★★★☆☆ | ★★☆☆☆ | ★★★☆☆ |

Source: NBS, CNNIC, iResearch, CMBIGM
Note: potential for increase in online penetration rate of local life services/OTA/e-commerce is based on the level of online GTV penetration rate, that of online advertising is based on the share of online advertising revenue, and that of online music/gaming is based on the penetration rate of online users; revenue and profit growth rating based on CMBI 2H24 estimates; competitive landscape rating is based on data such as CR5 market share; earnings resilience rating is based on factors such as the correlation between earnings growth rate and GDP growth rate

### Inclusion into Stock Connect to bring incremental funds, support valuaiton

On 9 September, the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE) issued notices that due to the rebalancing of Hang Seng Index, stocks such as Alibaba and Cloud Music were included into the Shanghai-Hong Kong Stock Connect. We believe incremental capital inflows from the stock connect program will raise the liquidity of Alibaba and Cloud Music and boost their valuations. For Meituan, Kuaishou and Bilibili, we note that following such inclusion, their average excess return peaked on the 11th trading day (+16%), with average daily trading value (ADTV) up by 53% on average. Other internet stocks not yet included in the Stock Connect may become eligible after meeting certain requirements: 1) for stocks such as NetEase, JD.com, Trip.com, Baidu, and Weibo, they need to be converted from secondary listing to dual listing; 2) for Beike and BOSS Zhipin, the liquidity and market cap of their H-shares will have to be strengthened.

### Figure 2: Internet: shareholder return summary

| | | | | | | Cash generation | | | Shareholder return | | | | Dividend | | | Share repurchase | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company | Ticker | Listing stat | HK stock | Price (Local) | Mkt cap (US$mn) | FY23 Net cash (US$mn) | FCF Yield FY24E | Net cash /Mkt cap FY23 | Div+Repo-SBC FY24E | Dividend Yield FY24E | Share Repo /Mkt cap FY24E | SBC/Mkt cap FY24E | DPS (local) FY24E | DPS (local) FY23 | Dividend Payout FY24E | Share repurchase (US$mn) FY24E | Share repurchase (US$mn) FY23 | Share repurchase (US$mn) FY22 |
| **China** | | | | | | | | | | | | | | | | | | |
| VIPShop | VIPS US | ADR only | N | 12.9 | 6,898 | 3,549 | 12.3% | 51.5% | 12.5% | 3.8% | 11.8% | -3.2% | 0.50 | 0.43 | 24.3% | (815) | (699) | (931) |
| JD.com | JD US | ondary listing | N | 26.9 | 42,849 | 28,524 | 12.5% | 66.6% | 10.2% | 2.8% | 9.1% | -1.7% | 0.75 | 0.76 | 26.5% | (3,900) | (356) | (271) |
| Weibo | WB US | ondary listing | N | 7.4 | 1,808 | 520 | 24.9% | 28.8% | 5.1% | 7.5% | 3.2% | -5.7% | 0.56 | 0.82 | 42.6% | (58) | NA | (58) |
| Alibaba | BABA US | Dual-primary | Y | 84.7 | 203,059 | 81,186 | 10.5% | 40.0% | 3.6% | 0.9% | 5.0% | -2.3% | 0.73 | - | 12.0% | (10,226) | (10,909) | (9,542) |
| NetEase | NTES US | ondary listing | N | 77.0 | 49,459 | 14,961 | 9.6% | 30.2% | 3.3% | 2.3% | 2.0% | -1.0% | 1.78 | 2.60 | 27.6% | (989) | (739) | (1,238) |
| Tencent | 700 HK | HK only | Y | 380.0 | 455,173 | 1,115 | 5.8% | 0.2% | 3.1% | 1.2% | 2.8% | -0.9% | 4.49 | 2.40 | 20.0% | (12,820) | (6,190) | (4,787) |
| TME | TME US | ondary listing | N | 9.5 | 16,303 | 3,691 | 6.5% | 22.6% | 2.9% | 0.7% | 2.9% | -0.6% | 0.06 | - | 10.7% | (465) | NA | (465) |
| Meituan | 3690 HK | HK only | Y | 128.6 | 100,281 | 11,905 | 3.5% | 11.9% | 2.1% | 0.0% | 3.5% | -1.4% | - | - | 0.0% | (3,500) | - | - |
| Beike | BEKE US | Dual-primary | N | 13.8 | 16,847 | 5,056 | 7.4% | 30.0% | 1.4% | 1.5% | 2.7% | -2.8% | 0.21 | - | 34.6% | (458) | (719) | (196) |
| Boss Zhipin | BZ US | Dual-primary | N | 12.4 | 5,599 | 1,779 | 6.5% | 31.8% | 1.1% | 0.5% | 2.4% | -1.8% | 0.06 | - | 11.0% | (137) | NA | (137) |
| Kingsoft | 3888 HK | HK only | Y | 21.8 | 3,734 | 2,961 | 11.4% | 79.3% | 0.3% | 0.9% | 0.7% | -1.3% | 0.19 | 0.13 | 20.3% | (28) | (31) | (24) |
| Kuaishou | 1024 HK | HK only | Y | 40.2 | 22,314 | 3,838 | 11.2% | 17.2% | 0.1% | 0.0% | 2.6% | -2.5% | - | - | 0.0% | (589) | (182) | - |
| Cloud Music | 9899 HK | HK only | Y | 90.8 | 2,511 | 1,338 | 6.7% | 53.3% | -0.4% | 0.0% | 0.1% | -0.5% | - | - | 0.0% | (2) | - | (5) |
| China Literature | 772 HK | HK only | Y | 25.3 | 3,319 | 845 | 4.7% | 25.5% | -0.6% | 0.0% | 0.0% | -0.6% | - | - | 0.0% | - | - | - |
| Trip.com | TCOM US | ondary listing | N | 46.7 | 31,887 | 1,939 | 7.0% | 6.1% | -0.9% | 0.0% | 0.1% | -0.9% | - | - | 0.0% | (26) | (224) | - |
| TCEL | 780 HK | HK only | Y | 13.9 | 4,155 | 863 | 12.8% | 20.8% | -1.0% | 0.7% | 0.0% | -1.7% | 0.10 | - | 10.9% | - | - | - |
| Pinduoduo | PDD US | ADR only | N | 98.4 | 136,627 | 29,156 | 16.2% | 21.3% | -1.1% | 0.0% | 0.0% | -1.1% | - | - | 0.0% | - | - | - |
| Baidu | BIDU US | ondary listing | N | 85.4 | 29,942 | 15,393 | 11.3% | 51.4% | -1.5% | 0.0% | 1.6% | -3.1% | - | - | 0.0% | (478) | (669) | (286) |
| Bilibili | BILI US | Dual-primary | Y | 15.1 | 6,378 | 1,068 | -1.1% | 16.7% | -2.1% | 0.0% | 0.8% | -2.9% | - | - | 0.0% | (52) | NA | (52) |
| **US** | | | | | | | | | | | | | | | | | | |
| Alphabet | GOOG US | NA | NA | 160.3 | 1,973,047 | 82,049 | 5.4% | 4.1% | 2.7% | 0.4% | 3.4% | -1.1% | 0.60 | - | 7.8% | (67,004) | (62,187) | (71,821) |
| Apple | AAPL US | NA | NA | 216.8 | 3,296,105 | 38,169 | 2.2% | 1.1% | 2.7% | 0.5% | 2.5% | -0.3% | 0.99 | 0.94 | 14.7% | (83,400) | (76,600) | (90,200) |
| Microsoft | MSFT US | NA | NA | 435.2 | 3,234,487 | (22,309) | 2.3% | -0.7% | 1.1% | 0.7% | 0.7% | -0.3% | 3.18 | 2.72 | 24.0% | (23,217) | (18,400) | (28,033) |
| Meta | META US | NA | NA | 536.3 | 1,356,779 | 27,479 | 3.4% | 2.1% | 0.9% | 0.4% | 1.8% | -1.2% | 2.00 | - | 9.4% | (23,980) | (20,030) | (27,930) |
| Nvidia | NVDA US | NA | NA | 115.6 | 2,835,423 | 14,928 | 2.2% | 0.5% | -0.1% | 0.0% | 0.3% | -0.4% | 0.04 | 0.16 | 1.6% | (8,560) | (10,040) | (7,080) |
| Tesla | TSLA US | NA | NA | 227.9 | 727,963 | 19,521 | 0.3% | 3.0% | -0.3% | 0.0% | 0.0% | -0.3% | - | - | 0.0% | - | - | - |
| Amazon | AMZN US | NA | NA | 186.9 | 1,961,412 | (67,776) | 2.8% | -3.8% | -1.2% | 0.0% | 0.2% | -1.4% | - | - | 0.0% | (3,000) | - | (6,000) |

Source: Bloomberg, company data, CMBIGM estimates

Note: 1) SBC – stock-based compensation; 2) FY24E share repurchase = average of FY23 & FY22 levels or based on our estimates; 3) FY24E net cash/cash flow/DPS/EPS estimates based on BBG consensus or our estimates; 4) data as of 17 Sep 2024

### Figure 3: Internet: trading after inclusion in Southbound Stock Connect

| | -60D | Inclusion | +11D | +20D | +40D | +60D |
|---|---|---|---|---|---|---|
| **Excess return (vs. HS Tech Index)** | | | | | | |
| Meituan | 36% | 2% | 3% | 5% | 1% | -10% |
| Kuaishou | -42% | 4% | 24% | 7% | 21% | 14% |
| BiliBili | -5% | 8% | 20% | 5% | -4% | -17% |
| **Average** | **-4%** | **4%** | **16%** | **6%** | **6%** | **-5%** |
| **Daily turnover (HK$mn)** | | | | | | |
| Meituan | 1,727 | 3,656 | 2,351 | 2,349 | 2,153 | 2,205 |
| Kuaishou | 1,809 | 3,670 | 3,191 | 2,378 | 2,137 | 2,105 |
| BiliBili | 631 | 1,325 | 926 | 812 | 564 | 484 |
| **Change in daily turnover** | | | | | | |
| Meituan | | 112% | 36% | 36% | 25% | 28% |
| Kuaishou | | 103% | 76% | 31% | 18% | 16% |
| BiliBili | | 110% | 47% | 29% | -11% | -23% |
| **Average** | | | **53%** | **32%** | **11%** | **7%** |
| **% of southbound holding** | | | | | | |
| Meituan | | | 1.34 | 1.92 | 2.87 | 3.49 |
| Kuaishou | | | 0.91 | 1.07 | 2.42 | 3.97 |
| BiliBili | | | 3.43 | 4.63 | 6.19 | 7.05 |
| **Mkt-cap weighted avg.** | | | **1.33** | **1.82** | **2.89** | **3.85** |

Source: Wind, CMBIGM

Southbound funds' shareholding ratio at Meituan, Kuaishou and Bilibili reached 1.33/1.82/2.89/3.85% on the 11th/20th/40th/60th trading day following their inclusion, based on market cap-weighted calculations. As at 10 Sep 2024, the ratio was 10.0%/14.4% for Tencent/Meituan. If we assume southbound funds' shareholding ratio at Alibaba is similar to Tencent's 10%, this would imply US$19.7bn in fund inflows, calculated based on Alibaba's market cap on the trading day prior to the inclusion.

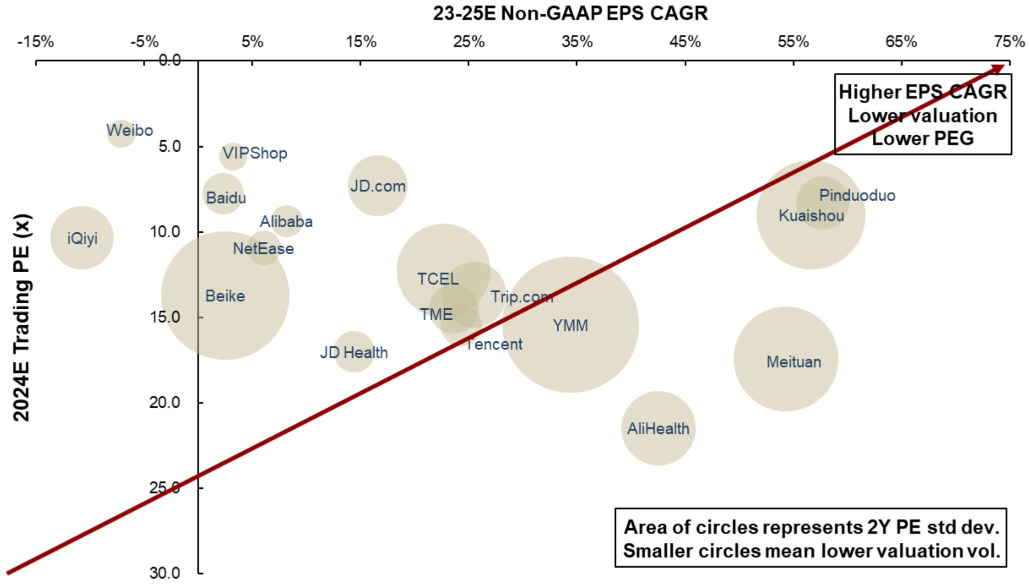
## Internet: valuations and fundamentals

### Figure 4: Internet: valuation and cash generation

| Company | Ticker | Price (LC) | Mkt cap (US$mn) | PE (x) 2024E | PE (x) 2025E | PS (x) 2024E | PS (x) 2025E | PEG 2024E | EPS CAGR 23-25E | ROE 2024E |
|---|---|---|---|---|---|---|---|---|---|---|
| Tencent | 700 HK | 377.8 | 455,499 | 15.5 | 13.9 | 4.9 | 4.5 | 0.6 | 24% | 20% |
| Alibaba | BABA US | 84.7 | 203,059 | 9.4 | 8.4 | 1.4 | 1.3 | 1.1 | 8% | 11% |
| Pinduoduo | PDD US | 98.4 | 136,627 | 8.3 | 6.9 | 2.4 | 1.9 | 0.1 | 58% | 45% |
| Meituan | 3690 HK | 126.5 | 100,574 | 17.5 | 14.0 | 2.1 | 1.8 | 0.3 | 54% | 20% |
| NetEase | NTES US | 77.0 | 49,674 | 10.9 | 10.0 | 3.3 | 3.0 | 1.8 | 6% | 23% |
| JD.com | JD US | 26.9 | 43,615 | 7.3 | 6.9 | 0.3 | 0.3 | 0.4 | 17% | 14% |
| Trip.com | TCOM US | 46.7 | 30,143 | 13.7 | 12.7 | 4.1 | 3.5 | 0.5 | 25% | 12% |
| Baidu | BIDU US | 85.4 | 29,942 | 7.8 | 7.7 | 1.6 | 1.5 | 3.4 | 2% | 9% |
| Kuaishou | 1024 HK | 39.9 | 22,330 | 9.0 | 7.1 | 1.2 | 1.1 | 0.2 | 57% | 27% |
| Beike | BEKE US | 13.8 | 16,849 | 13.7 | 11.9 | 1.4 | 1.2 | NA | 2% | 9% |
| TME | TME US | 9.5 | 16,303 | 14.5 | 12.4 | 4.1 | 3.7 | 0.6 | 24% | 12% |
| New Oriental | EDU US | 61.3 | 10,137 | 25.7 | 18.4 | 2.4 | 1.9 | 0.4 | 70% | 12% |
| JD Health | 6618 HK | 22.5 | 9,497 | 17.0 | 15.3 | 1.2 | 1.0 | 1.2 | 14% | 7% |
| YMM | YMM US | 7.5 | 7,864 | 15.4 | 12.0 | 5.3 | 4.4 | NA | 34% | 9% |
| VIPShop | VIPS US | 12.9 | 6,898 | 5.6 | 5.5 | 0.5 | 0.4 | NA | NA | 20% |
| Bilibili | BILI US | 15.1 | 6,378 | NA | 28.4 | 1.7 | 1.5 | NA | NA | -8% |
| Ali Health | 241 HK | 2.8 | 5,884 | 21.5 | 21.5 | 1.3 | 1.3 | 0.5 | 43% | 11% |
| Boss Zhipin | BZ US | 12.4 | 5,560 | 15.7 | 13.4 | 5.3 | 4.5 | 0.7 | 21% | 15% |
| SenseTime | 20 HK | 1.1 | 4,960 | NA | NA | 7.9 | 6.1 | NA | NA | -20% |
| TCEL | 780 HK | 14.2 | 4,158 | 12.3 | 10.2 | 1.7 | 1.5 | 0.5 | 23% | 11% |
| Kingsoft | 3888 HK | 21.5 | 3,737 | 20.9 | 17.1 | 2.7 | 2.4 | 0.3 | 65% | 6% |
| China Lit | 772 HK | 25.4 | 3,321 | 16.9 | 15.1 | 3.1 | 2.9 | 0.9 | 18% | 6% |
| Cloud Music | 9899 HK | 91.1 | 2,511 | 13.5 | 11.9 | 2.2 | 2.0 | 0.2 | 55% | 14% |
| iQIYI | IQ US | 2.1 | 1,967 | 10.4 | 6.9 | 0.5 | 0.4 | NA | -11% | 9% |
| Weibo | WB US | 7.4 | 1,803 | 4.3 | 4.1 | 1.0 | 1.0 | NA | -7% | 11% |
| PA Healthcare | 1833 HK | 9.5 | 1,371 | NA | NA | 2.1 | 1.9 | NA | NA | 1% |
| Baozun | BZUN US | 2.6 | 154 | NA | 8.8 | 0.1 | 0.1 | NA | NA | -2% |
| **Average** | | | | **13.4** | **12.5** | **2.5** | **2.2** | | | |
| | | | | | | | | | | |
| Microsoft | MSFT US | 435.2 | 3,234,487 | 36.8 | 33.0 | 13.2 | 11.5 | 2.2 | 17% | 32% |
| NVIDIA | NVDA US | 115.6 | 2,835,423 | NA | 40.8 | 47.8 | 22.6 | NA | 194% | 94% |
| Alphabet | GOOGL US | 159.3 | 1,967,006 | 20.2 | 17.9 | 6.1 | 5.6 | 1.0 | 21% | 30% |
| Amazon | AMZN US | 186.9 | 1,961,412 | 32.7 | 28.0 | 3.1 | 2.8 | 1.0 | 32% | 19% |
| Meta | META US | 536.3 | 1,356,942 | 24.8 | 21.7 | 8.4 | 7.4 | 0.9 | 29% | 32% |
| Tesla | TSLA US | 227.9 | 727,963 | NA | NA | 7.3 | 6.3 | NA | 1% | 11% |
| Netflix | NFLX US | 706.9 | 303,381 | 36.8 | 30.8 | 7.8 | 7.0 | 1.0 | 37% | 37% |
| Salesforce | CRM US | 255.2 | 243,962 | 31.1 | 25.3 | 7.0 | 6.4 | 0.7 | 43% | 14% |
| Adobe | ADBE US | 515.0 | 228,364 | 28.2 | 25.1 | 10.6 | 9.6 | 2.1 | 14% | 43% |
| ServiceNow | NOW US | 885.8 | 182,481 | NA | NA | 16.7 | 13.9 | NA | 26% | 25% |
| Intuit | INTU US | 644.8 | 180,738 | 38.3 | 33.3 | 11.2 | 9.9 | 2.3 | 17% | 25% |
| Uber | UBER US | 72.8 | 152,906 | NA | 29.4 | 3.5 | 3.0 | NA | 83% | 19% |
| PANW | PANW US | 337.9 | 110,030 | NA | NA | 13.8 | 12.1 | NA | 21% | 34% |
| Shopify | SHOP US | 74.5 | 96,151 | NA | NA | 11.1 | 9.2 | NA | 40% | 10% |
| Workday | WDAY US | 248.1 | 65,752 | 43.2 | 35.4 | 9.1 | 7.8 | 1.1 | 41% | 14% |
| **Average** | | | | **32.5** | **29.2** | **11.9** | **9.1** | | | |

Source: Bloomberg, CMBIGM
Note: data as of 17 Sep 2024; earnings estimate based on BBG consensus

**Figure 5: Internet: valuation, earnings growth and valuation volatility comps**

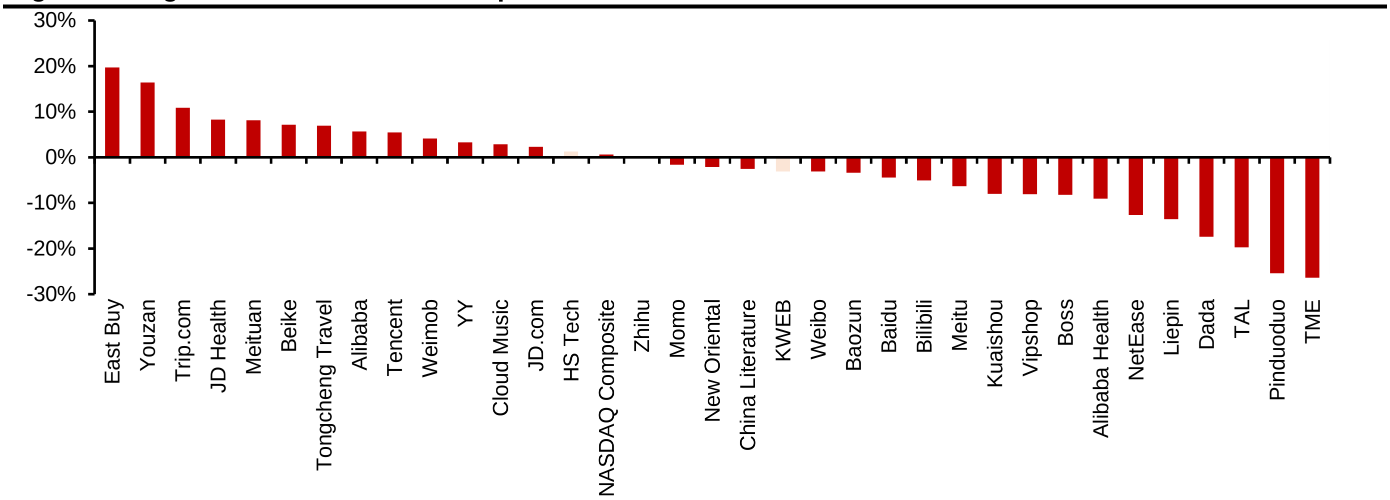



Source: Bloomberg, CMBIGM
Note: data as of 17 Sep 2024; earnings estimate based on BBG consensus

While the market has already begun to trade on the Fed's rate cuts, investors in the Hong Kong market are still focused on corporate earnings instead of liquidity. For the internet sector, we believe recovery of consumption in the long run, supported by waning risks associated with the property sector, is still the core driver of the sector's mid- to long-term valuation. In the meantime, consumption stimulus measures and their impacts may be short-term catalysts that could have a bearing on market sentiment.

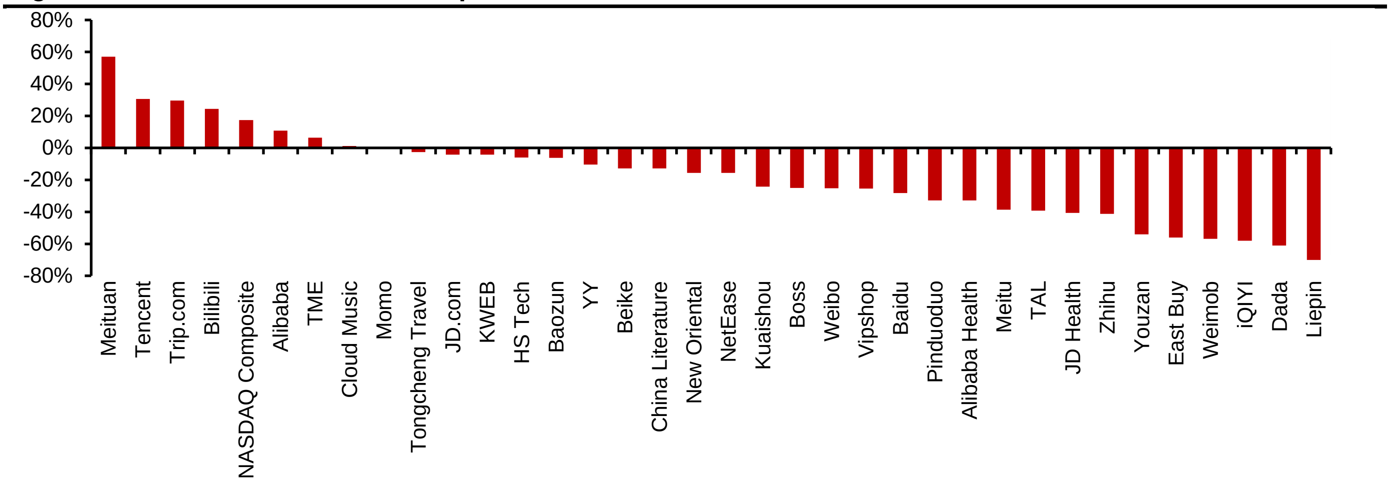
The overall sector performance in August echoed our previous view that better-than-expected 2Q results were not enough for a stock rally, but better-than-expected 3Q outlooks and enhanced shareholder returns served as major drivers for the rallies. Trip.com, Meituan, Alibaba and Tencent were the outperformers thanks to the above. For September, with investors still on the lookout, we would recommend: 1) companies with improving fundamentals and poised to see incremental funds following the Stock Connect inclusion, such as Alibaba; 2) those whose fundamentals are resilient and full-year outlook has been revised upward, such as Meituan and Trip.com; 3) Bilibili, which stands to benefit from new game launches; and 4) companies whose core business enjoys a stable competitive landscape and fundamentals are robust, and which are willing to raise shareholder returns, such as Tencent. We also suggest investors keep an eye on Pinduoduo, as its valuation now looks subdued but new growth drivers may bring upside potential.

**Figure 6: August internet sector share price movement**




Source: Wind, CMBIGM

**Figure 7: YTD internet sector share price movement**




Source: Wind, CMBIGM
Note: data as of 17 Sep 2024

## Sub-sector recap and trend analysis

### Local life services: better landscape, fundamental improvement likely to be sustainable

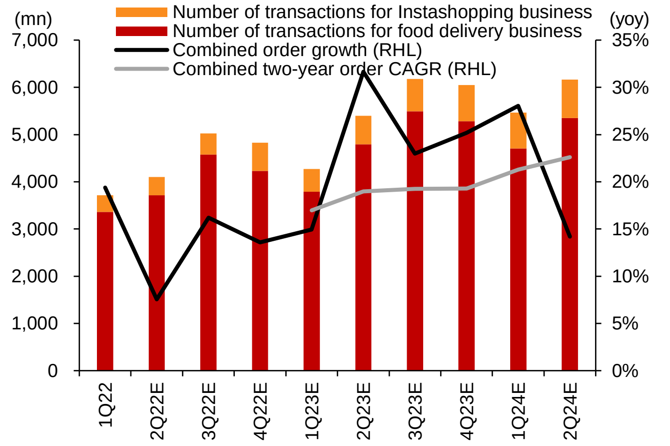
Compared with 1Q24, the local life services sector maintained relatively rapid GTV growth in 2Q24, as a result of still-low online penetration and continued expansion in low-tier cities. We expect such trend to continue in 3Q24, with Meituan in-store (excl. hotel and travel) GTV likely to sustain 40%+ YoY growth. Meanwhile, we note that competition has been marginally easing, which we think is because: 1) for the in-store vertical, short-video platforms' user traffic and user time spent growth has moderated, and refining operation and improving monetization on traffic have become priorities to best leverage the existing user traffic; and 2) for food delivery services, industry players continue to enhance user operation and cut down on ineffective subsidies amid macro headwinds, which prompt us to believe that improvement in fundamentals shall continue in 3Q, and full-year earnings outlook may turn for the better.

Our observations from local life services players' 2Q24 results are as follows. 1) Food delivery services: User subsidies dropped industrywide, a focus on profitability helped improve the competitive landscape, and merchants' efforts to snap up online traffic drove better ads monetization on delivery platforms and significant YoY improvement or rises of unit economics (UE) of core platforms. 2) In-store business: Despite a sequential enhancement in subsidies by Douyin, the outcome was weaker than the market had previously expected; for Meituan, however, it saw market share in key in-store service categories stabilizing and even share gains in certain categories in the peak season in terms of GTV after coupon validation, which has eased market concerns. Its 2Q in-store profit margin picked up more rapidly QoQ than the market had expected. 3) Community group buying and others: The profitability of community group buying has been optimized industrywide as operational efficiency becomes the focus. For Meituan, overall stable profit generation from other new initiatives may prompt the market to re-assess the value of these initiatives as well as the company's overall valuation.

In terms of the profitability of food delivery business, we estimate Meituan's per-order delivery profit reached a record high in 2Q24, mainly thanks to: 1) a fall in the percentage of delivery-related cost in food delivery and Instashopping revenues; 2) changes in revenue mix and increased advertising monetization; and 3) user subsidy optimization. In addition, Alibaba's Local Services Group (Ele.me being the main revenue and loss contributor) also saw a significantly narrower loss in 2Q24 at RMB400mn, vs. a loss of RMB2bn in 2Q23.

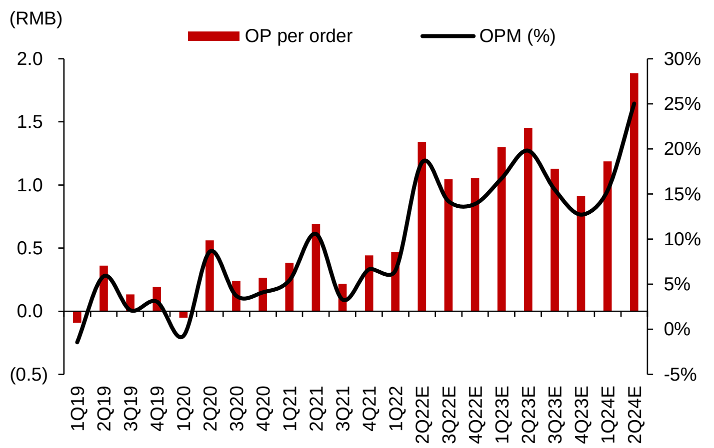
We still see substantial room to improve the overall online penetration rate of the local life services sector. While competition and the shift from agency to direct operation model may dent Meituan in-store business's mid- to long-term profit margin outlook, rapid GTV growth and a stabilizing monetization trend may continue to support stable operating profit growth. Moreover, given optimized subsidies for food delivery business, a better UE outlook for on-demand delivery underpinned by improved ad monetization, as well as better-than-expected loss reduction in Meituan Select, helped by operational efficiency gains and business adjustments, we are turning more positive on Meituan's 2024 net profit outlook. The stock is trading at 17.5x 2024E PE, attractive in our view considering a 37% group-level non-GAAP net profit CAGR for 2023-2026E, and a 20% operating profit CAGR for its Core Local Commerce business.

## Figure 8: Meituan: the no. of orders of "to-home" business and growth trend



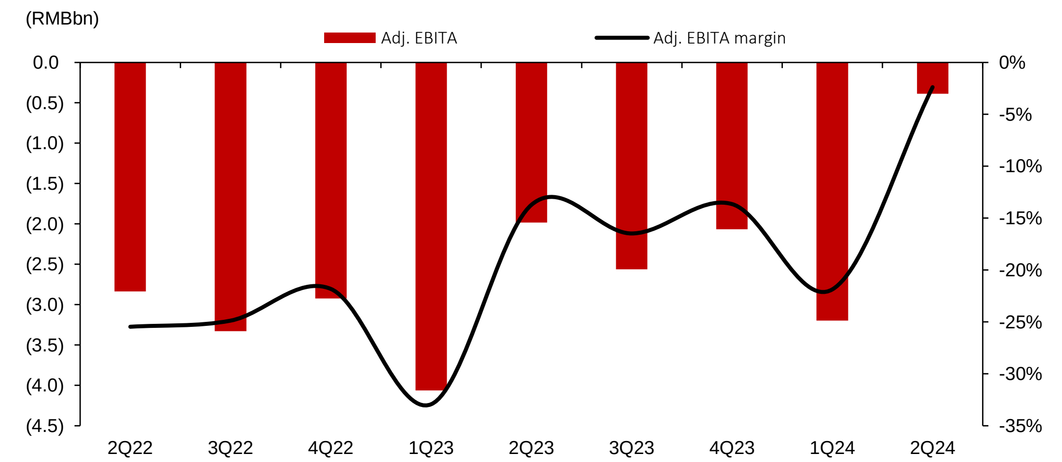

Source: Company data, CMBIGM estimates

## Figure 9: Meituan: per-order OP of food delivery business




Source: Company data, CMBIGM estimates

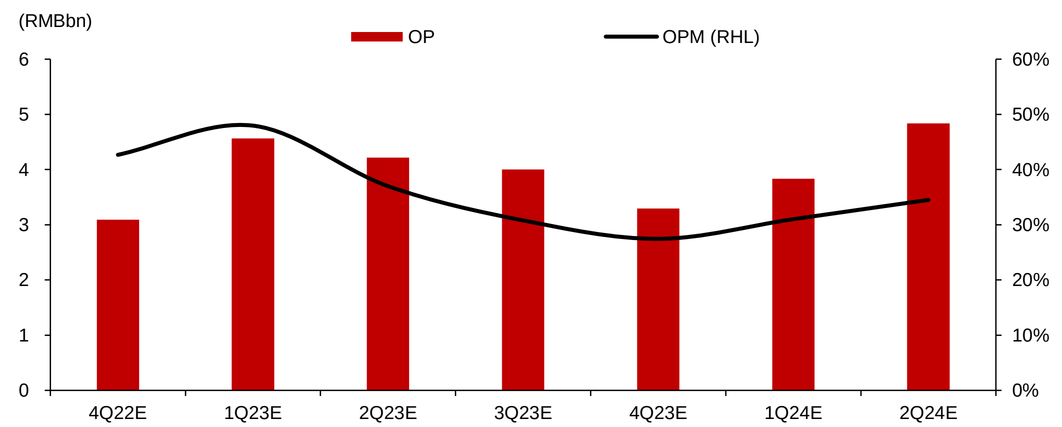
## Figure 10: Alibaba Local Services Group: adjusted EBITA and margin




Source: Company data, CMBIGM estimates

In terms of competition in the in-store space, we note that Meituan's in-store, hotel and travel profit margin picked up more rapidly QoQ in 2Q24 than the market had anticipated, implying overall softer-than-expected competition in the industry.

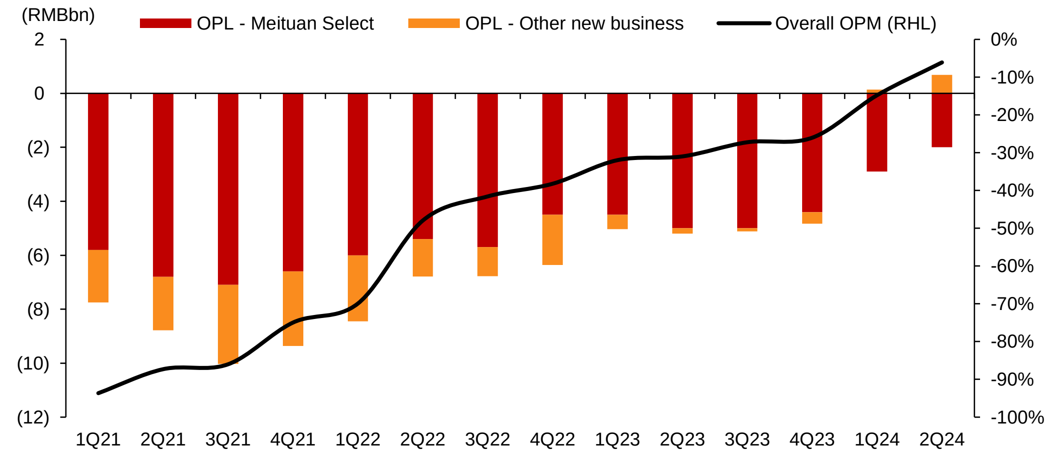
## Figure 11: Meituan: OP and OPM of in-store & travel business




Source: Company data, CMBIGM estimates

For Meituan's new initiatives, the segment generated revenue of RMB21.6bn in 2Q24, up 29% YoY, driven by strong revenue growth from Xiaoxiang Supermarket and Kuailv, while the operating loss of new initiatives was RMB1.3bn, with the loss margin narrowing significantly to 6.1% (2Q23: 31.0%), driven by better-than-expected performance of retail and other businesses (such as bike-sharing) amid favorable seasonality. Operating loss generated from Meituan Select was RMB2.0bn, narrowing from RMB5.0bn/RMB2.9bn in 2Q23/1Q24. For 3Q24, we expect Meituan Select to see further loss reduction to RMB1.8bn (3Q23: RMB5.0bn), and other new businesses to sustain a breakeven level in a relatively low season. Except for Meituan Select, we believe stable profit generation from other new initiatives will lead the market to re-assess their value as well as the company's overall valuation.

**Figure 12: Meituan: operating loss and operating loss margin of new initiatives**




Source: Company data, CMBIGM

## Paid content: Postive on online music streaming platforms' resilient fundamentals

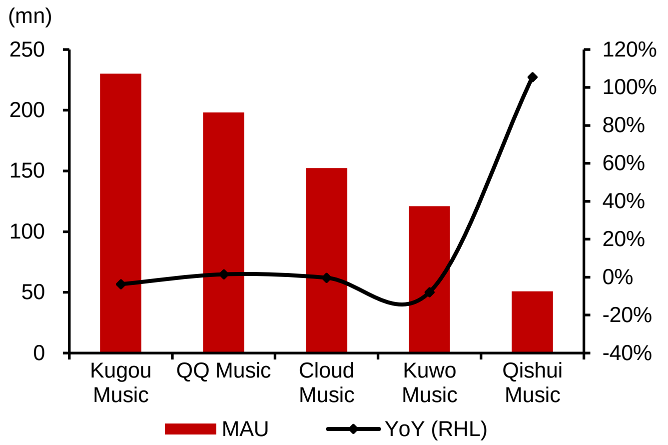
Despite the macro headwinds, the business outlook and competitive landscape of the online music streaming sector has remained stable in 2H24, making us upbeat on the platforms' revenue and profit growth prospects. However, the revenue growth driver is shifting from paying user growth to balanced growth of paying users and ARPPU. We estimate leading online music streaming services platforms' YoY music revenue growth to be maintained at 15-25% in 2H24, and their profit margins to improve as well thanks to operational leverage and a rising portion of self-produced content. For online video streaming services, competition remains tense in 2H24, and platforms have to invest in content to maintain market share and retain existing users. As a result, their fundamentals and share price may fluctuate significantly along with the performance of content. Disappointing content performance may put pressure on the platforms' revenue and profits. For iQIYI, we expect YoY drops in both 2H revenue and operating profit.

In terms of valuation, we expect the premium of Tencent Music Entertainment (TME) (14.5x FY24E PE) over Cloud Music (13.5x FY24E PE) to narrow, given that: 1) some investors are worried about TME's short- to medium-term paying user growth prospects, which may weigh on valuation; 2) Cloud Music joined the Stock Connect on 10 Sep, and the resultant improvement in stock liquidity may help erase the valuation discount due to the liquidity issue to a certain extent. iQIYI's valuation may continue to be suppressed in the short term, until a rebound in its content performance and fundamentals appears.

**Online music:** Leading online music streaming platforms' advantage in user traffic is still solid. As of end-Jun 2024, TME's Kugou Music/QQ Music/Kuwo Music had a user base of 230/198/121mn and Cloud Music had 152mn, which remained relatively stable. ByteDance's Qishui Yinyue saw rapid user growth of +106% YoY in Jun 2024, which brought the total to 50.83mn, although this was still far behind key platforms and was only equivalent to 22/26/33/42% of Kugou Music/QQ Music/Cloud Music/Kuwo Music users.

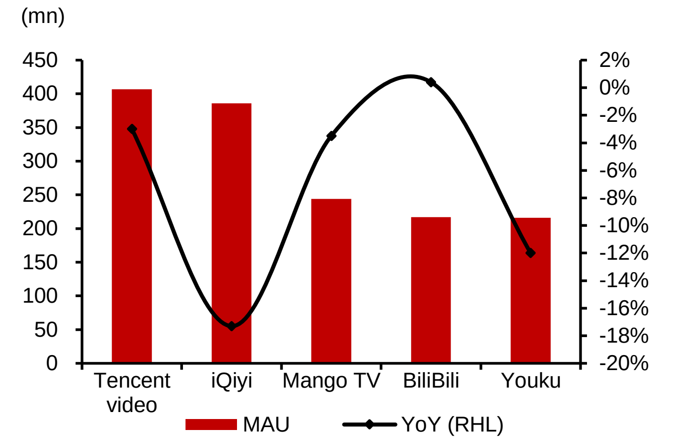
**Online video:** Leading video streaming platforms' user traffic performance diverged. The number of iQIYI/Youku users fell by 17/12% YoY to 386/216mn respectively in Jun 2024, due to the relatively lackluster content performance. Tencent Video/Bilibili were relatively robust, with a stable number of users at 407/217mn in Jun 2024.

**Figure 13: China: online music user trend (Jun-24)**




Source: QuestMobile, CMBIGM

**Figure 14: China: online video user trend (Jun-24)**




Source: QuestMobile, CMBIGM

**Online music**: despite the macro headwinds, we are positive that online music streaming platforms can still maintain sound revenue and profit growth, with relatively high earnings growth visibility. We recommend TME and Cloud Music. Our review of the platforms' 2Q24 results shows that: 1) their GPM could continue to improve on operational leverage, a rising share of self-made content, and more rational content costs; and 2) the number of paying users may still rise, albeit at a slower pace. Leading players are putting a greater emphasis on lifting ARPPU, and we believe music streaming platforms' ARPPU has greater upside potential compared with other forms of paid content.

By platform, 1) TME's online music revenue increased by 28% YoY to RMB5.42bn in 2Q24, of which member/non-member revenue increased by 29/24% YoY respectively. The number of paying subscribers rose by 18% YoY to 117mn in 2Q24, a net increase of 3.5mn QoQ, and the monthly ARPPU grew by 10% YoY to RMB10.7. Looking ahead to 2H24, we expect the net increase of TME's paying subscribers to slow down (1.5-2mn per quarter), but ARPPU to continue improving sequentially, mainly thanks to the growth of high-priced super VIP members. For 2H24, we forecast 22% YoY growth in TME's online music revenue. 2) Cloud Music's online music revenue grew by 27% YoY to RMB2.56bn in 1H24, of which membership subscription revenue increased by 25% YoY to RMB2.14bn, mainly driven by the increase in the number of monthly paying users. For 2H24, we expect Cloud Music's online music revenue to grow 16% YoY, primarily driven by paying user growth.

**Online video:** The industry remains highly competitive, and platforms continue to invest in content to maintain a competitive advantage, resulting in low profit margins. Content performance that exceeds or falls short of expectations can lead to large fluctuations in platforms' earnings. iQIYI's total revenue in 2Q24 fell 5% YoY to RMB7.4bn, and its non-GAAP operating profit fell 36% YoY to RMB501mn, mainly due to the weak performance of some drama series and fierce competition. For 3Q24, we expect its membership and ad revenue growth to remain under pressure, and it will take time for the improvement in content performance to be reflected in the company's financials. As a result, we expect total 3Q24 revenue to decline 9% YoY to RMB7.3bn and non-GAAP operating profit to fall 63% YoY to RMB335mn.

**Figure 15: China paid content platform: quarterly trend**

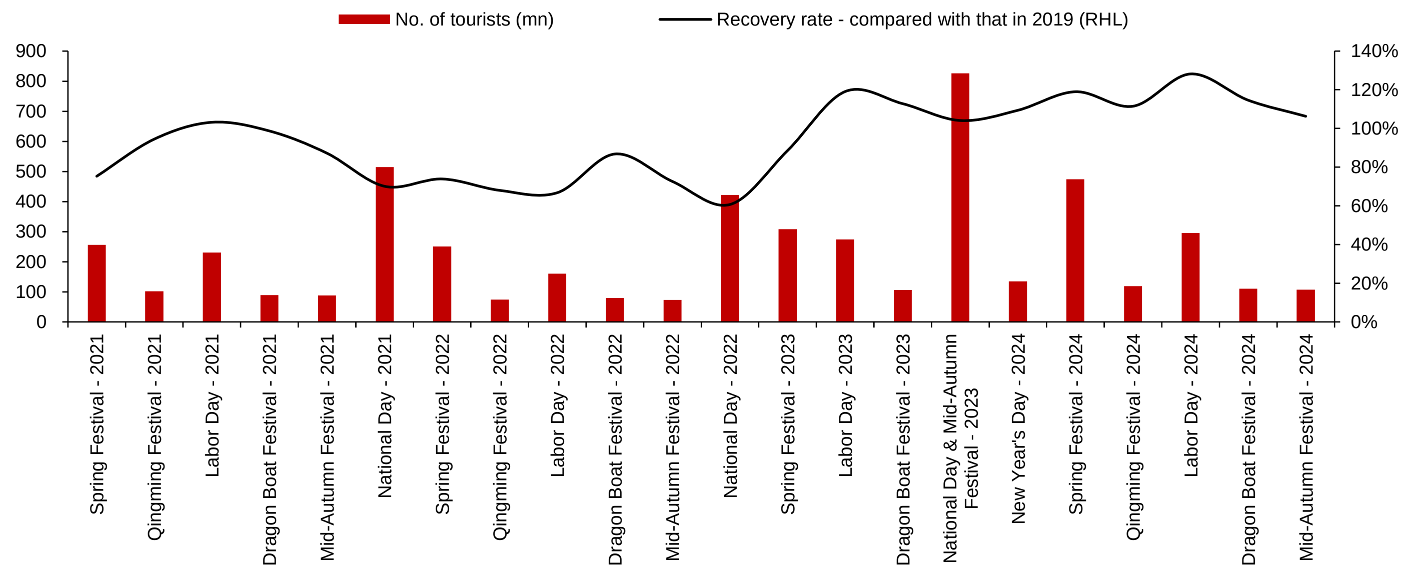
| Membership revenue (RMBmn) | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | 3Q23 | 4Q23 | 1Q24 | 2Q24 |
|---|---|---|---|---|---|---|---|---|---|---|
| TME | 1,993 | 2,107 | 2,249 | 2,352 | 2,599 | 2,890 | 3,193 | 3,417 | 3,618 | 3,740 |
| Cloud Music | 885 | 899 | 953 | 962 | 996 | 1,026 | 1,145 | 1,185 | 1,273 | 1,287 |
| iQIYI | 4,471 | 4,285 | 4,211 | 4,744 | 5,547 | 4,947 | 5,012 | 4,809 | 4,799 | 4,495 |
| BiliBili (VAS) | 2,052 | 2,103 | 2,210 | 2,350 | 2,156 | 2,302 | 2,595 | 2,857 | 2,529 | 2,566 |
| Kuaishou (live streaming) | 7,842 | 8,565 | 8,947 | 10,034 | 9,319 | 9,968 | 9,719 | 10,048 | 8,575 | 9,302 |
| **YoY** | **1Q22** | **2Q22** | **3Q22** | **4Q22** | **1Q23** | **2Q23** | **3Q23** | **4Q23** | **1Q24** | **2Q24** |
| TME | 18% | 18% | 18% | 21% | 30% | 37% | 42% | 45% | 39% | 29% |
| Cloud Music | 16% | 6% | 11% | 17% | 13% | 14% | 20% | 23% | 28% | 25% |
| iQIYI | 4% | 7% | -2% | 15% | 24% | 15% | 19% | 1% | -13% | -9% |
| BiliBili (VAS) | 37% | 29% | 16% | 24% | 5% | 9% | 17% | 22% | 17% | 11% |
| Kuaishou (live streaming) | 8% | 19% | 16% | 14% | 19% | 16% | 9% | 0% | -8% | -7% |
| **Paid memberhsip (mn)** | **1Q22** | **2Q22** | **3Q22** | **4Q22** | **1Q23** | **2Q23** | **3Q23** | **4Q23** | **1Q24** | **2Q24** |
| TME | 80 | 83 | 85 | 89 | 94 | 99 | 103 | 107 | 114 | 117 |
| Cloud Music | 37 | 38 | 39 | 39 | 41 | 43 | 45 | 48 | 51 | 54 |
| BiliBili (VAS) | 27 | 28 | 29 | 28 | 29 | 26 | 29 | 28 | 29 | 29 |
| Kuaishou (live streaming) | 57 | 54 | 60 | 58 | 60 | 55 | 59 | 59 | 58 | 55 |
| **Monthly ARPPU (RMB)** | **1Q22** | **2Q22** | **3Q22** | **4Q22** | **1Q23** | **2Q23** | **3Q23** | **4Q23** | **1Q24** | **2Q24** |
| TME | 8.3 | 8.5 | 8.8 | 8.9 | 9.2 | 9.7 | 10.3 | 10.7 | 10.6 | 10.7 |
| Cloud Music | 8.0 | 7.8 | 8.2 | 8.2 | 8.2 | 8.0 | 8.4 | 8.3 | 8.4 | 8.0 |
| BiliBili (VAS) | 25.1 | 25.5 | 25.8 | 27.9 | 24.8 | 29.5 | 29.8 | 34.0 | 29.1 | 29.5 |
| Kuaishou (live streaming) | 46.3 | 52.7 | 50.0 | 57.3 | 51.7 | 60.4 | 54.9 | 57.1 | 49.4 | 56.0 |

Source: Company data, CMBIGM
Note: iQIYI did not disclose paid membership or monthly ARPPU data

## OTA: Resilient domestic business despite high base, outbound business steadily recovering

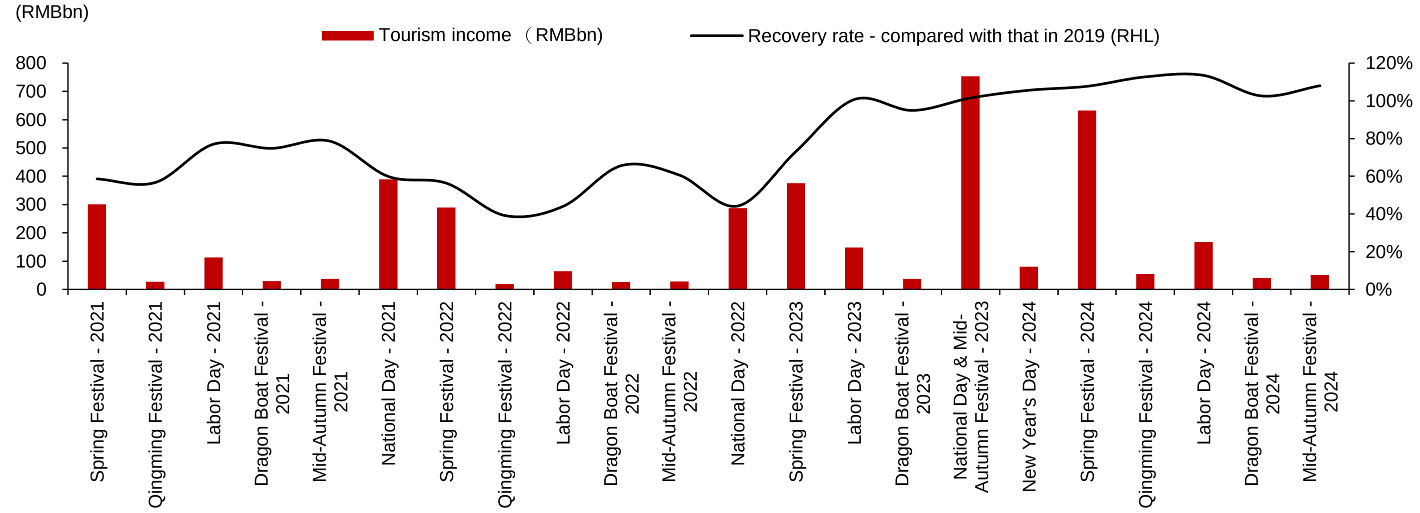
Holiday travel bookings data in 2Q24 showed that domestic travel demand maintained moderate and healthy growth on a high base, while the recovery of outbound travel business was well on track. Core OTAs' booking data QTD in 3Q24 have been better than the weaker expectations given by the market due to concerns about deflation, which in our view indicates OTAs' resilient earnings performance.

**Figure 16: China: No. of tourists during major holidays and recovery rate compared with that in 2019**




Source: Ministry of Culture and Tourism of China; CMBIGM

**Figure 17: China: total tourism income of major holidays and recovery rate compared with that in 2019**




Source: Ministry of Culture and Tourism of China; CMBIGM

We expect Trip.com's domestic air ticket reservations to maintain a mid-to-high single-digit YoY growth in 3Q, and domestic hotel reservations to maintain 15%+ YoY growth. In terms of outbound travel, demand recovered to 75% of the pre-COVID level in 2Q, and we expect it to further recover to 80-90% of the pre-COVID level, with Trip.com's outbound air ticket and hotel reservations recovery rate likely to be 20-30ppt higher than the industrywide rate.

We estimate Tongcheng Travel's domestic and international air ticket reservations growth to stay at 20%+ YoY in 3Q24, and domestic and international hotel room-nights growth to reach 15% YoY. We also expect scaling-back of user subsidies amid easing competition and a rise in hotel take-rate to bolster earnings growth. We forecast the company's 3Q24 revenue to grow by 13.4% YoY (2Q24: 13.6%) to RMB15.6bn, and non-GAAP operating profit to grow by 16.6% YoY to RMB5.2bn. We estimate its core OTA business revenue to rise 20% YoY to RMB4bn in 3Q24, and the group's non-GAAP net profit to jump 50% YoY to RMB854mn.

We are positive on Trip.com's domestic and outbound travel businesses and expect them to maintain solid revenue growth, aided by its one-stop platform, strong mobile experience, excellent customer services and strengthening supply chain capabilities. We believe the company is well-positioned to tap into other international markets with low online penetration, thus driving long-term revenue and earnings growth. The stock is currently trading at 13.7/12.7x 2024/2025E PE. As we forecast its non-GAAP operating profit in 2024 to increase by 26% YoY and 2023-2025E operating profit CAGR to reach 19%, we still see upside potential in the stock's valuation.

## Online games: New products to drive earnings rebound in 2H24

According to GPC, China's gaming market revenue increased by 2% YoY to RMB147.3bn in 1H24, with mobile games revenue up by 1% YoY to RMB107.5bn, mainly thanks to the strong performance of popular titles such as *DnF Mobile* and *San Guo: Mou Ding Tian Xia* (三国: 谋定天下), which was partially offset by the decline in revenue of evergreen games. In 1H24, the sector's regulatory environment gradually normalized, and the National Press and Publication Administration issued a total of 733 domestic game approvals in 1H24, representing a YoY increase of 38%.

Fundamentals of game companies were still at the bottoming stage in 1H24. For 2H24, we expect the industry climate to improve, and revenue contribution of key new products to be further reflected in financials. We like companies capable of maintaining strong earnings growth in 2H24 or those equipped with a high-quality product pipeline, including Tencent (we expect its 2H24 games revenue to increase 15% YoY), Bilibili (expect 2H24 games revenue to increase 55% YoY), and NetEase (short-term games revenue growth under pressure, a high-quality game pipeline in 2H24):

1) Tencent's 2Q24 games revenue grew 9% YoY to RMB48.5bn, with domestic/overseas revenue up 9/9% YoY and gross receipts growth outpacing revenue growth. Domestic games revenue growth was mainly driven by incremental contribution from *VALORANT* and *DnF Mobile*. The former has become the highest-grossing PC game in the domestic market after being launched for one year, while the robust grossing from *DnF Mobile* was only partially reflected in 2Q24 revenue growth. With the revenue of evergreen titles recovering and *DnF Mobile* revenue continuing to grow, we expect Tencent's games revenue growth to accelerate in 2H24, at 15% YoY.

2) Bilibili's 2Q24 mobile games revenue rose 13% YoY to RMB1.0bn, mainly due to the successful launch of *San Guo: Mou Ding Tian Xia*. Strong grossing performance of the game upon launch drove deferred revenue in 2Q24 up by RMB738mn QoQ. As the game was launched near the end of 2Q (on 13 June) and games revenue recognition is normally deferred by c. three months, we believe the strong grossing of *San Guo* will contribute to robust games revenue growth for Bilibili in 2H24, at 55% YoY.

3) NetEase's 2Q24 games and related value-added services revenue increased by 7% YoY to RMB20.1bn, thanks to the solid performance of legacy titles such as *Identity V* and *Fantasy Westward Journey Mobile*, which was partially offset by adjustments to *Fantasy*

*Westward Journey PC,* minors protection measures taken against *Eggy Party,* and the normalization of *Justice Mobile* revenue. For 2H24, considering the adjustments made to some games, we expect NetEase's games revenue to face short-term pressure, but still the performance of some new titles looks promising, which may propel earnings and valuation thereafter. These include: 1) *Marvel Rivals* (slated for 6 December), which had over 50,000 peak concurrent users on Steam on the first day of beta testing and pre-registrations of over 100mn, ranking top 5 on Steam's pre-registration chart; and 2) *Where Winds Meet*, which had PC/mobile cross-platform compatibility testing completed by 1 Sep, with release scheduled within the year.

**Figure 18: China: quarterly games revenue trend**

| (RMBbn) | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | 3Q23 | 4Q23 | 1Q24 | 2Q24 |
|---|---|---|---|---|---|---|---|---|---|---|
| Games market revenue | 79.5 | 68.3 | 59.7 | 58.4 | 67.5 | 76.8 | 84.2 | 74.5 | 72.6 | 74.6 |
| Mobile games market revenue | 60.4 | 50.0 | 41.6 | 40.9 | 48.7 | 58.0 | 64.9 | 55.1 | 52.9 | 54.6 |
| Overseas game (US$bn) | 4.6 | 4.4 | 4.3 | 4.1 | 3.9 | 4.3 | 4.3 | 3.9 | 4.1 | 4.5 |
| | | | | | | | | | | |
| YoY – Games market | 3% | -7% | -19% | -19% | -15% | 12% | 41% | 28% | 8% | -3% |
| YoY – Mobile games market | 3% | -10% | -25% | -26% | -19% | 16% | 56% | 35% | 9% | -6% |
| YoY – Overseas games | 12% | 1% | -14% | -11% | -15% | -2% | 0% | -5% | 5% | 3% |
| | **1Q22** | **2Q22** | **3Q22** | **4Q22** | **1Q23** | **2Q23** | **3Q23** | **4Q23** | **1Q24** | **2Q24** |
| Tencent games revenue | 43.6 | 42.5 | 42.9 | 41.8 | 48.4 | 44.5 | 46.0 | 40.9 | 48.1 | 48.5 |
| NetEase games revenue | 18.6 | 18.1 | 18.7 | 19.1 | 20.1 | 18.8 | 21.8 | 20.9 | 21.5 | 20.1 |
| BiliBili games revenue | 1.4 | 1.0 | 1.5 | 1.1 | 1.1 | 0.9 | 1.0 | 1.0 | 1.0 | 1.0 |
| | | | | | | | | | | |
| YoY – Tencent | 0% | -1% | -5% | -2% | 11% | 5% | 7% | -2% | -1% | 9% |
| YoY – NetEase | 16% | 15% | 9% | 2% | 8% | 4% | 16% | 10% | 7% | 7% |
| YoY - BiliBili | 16% | -15% | 6% | -12% | -17% | -15% | -33% | -12% | -13% | 13% |

Source: GPC, company data, CMBIGM

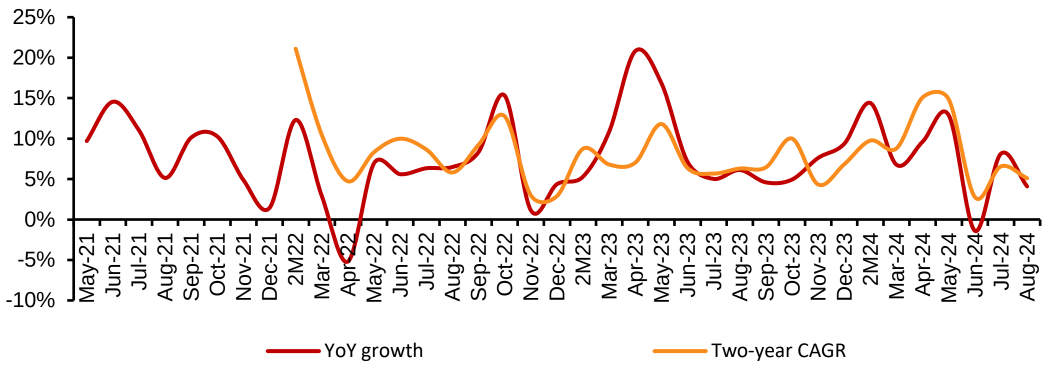
## E-commerce: Consumption recovery and shareholder return remain key to valuation; not overly concerned on intensifying domestic competition with ROI focus

In July, the YoY growth rate of online retail sales of physical goods rebounded MoM, easing market concerns on significant weakening of consumption. The YoY growth, however, retreated again in August. The relatively volatile MoM growth rate indicated that the overall recovery momentum of consumption was subdued. The performance of e-commerce platforms in 2Q24 shows that although the leading players have guided for continuous investments to drive GMV growth, they are largely more focused on ROI. In view of this, we believe that the competitive landscape of China's e-commerce industry may not worsen significantly. Backed by relatively stable profitability, the rise of shareholder return among e-commerce platforms may provide support for valuation. Further re-rating may hinge on the steady recovery of consumption. Overseas expansion remains the key driver of long-term revenue and profit growth. We maintain BUY for Alibaba, PDD, and JD.com.

- **Online retail sales of physical goods further retreated YoY in Aug, full-year consumption recovery may still face challenges**

As an increasing number of e-commerce platforms kicked off sales in May for the 618 Shopping Festival, more e-commerce sales originally in June were shifted to May, resulting in a significant slowdown in online retail sales of physical goods in June. Although such trend is in line with our expectations, the level of decline is greater-than-expected. In our view, the data may be partly explained by the weaker-than-expected growth in overall retail sales of consumer goods, but it also arouses market attention on significant weakening of consumption. Even though the YoY rebound of online retail sales of physical goods in July partly eased market concerns, the growth rate in August and the two-year CAGR dropped again, indicating that the overall recovery momentum of consumption may still be subdued.

**Figure 19: China: growth and 2-year CAGR of online retail sales GMV of physical goods**

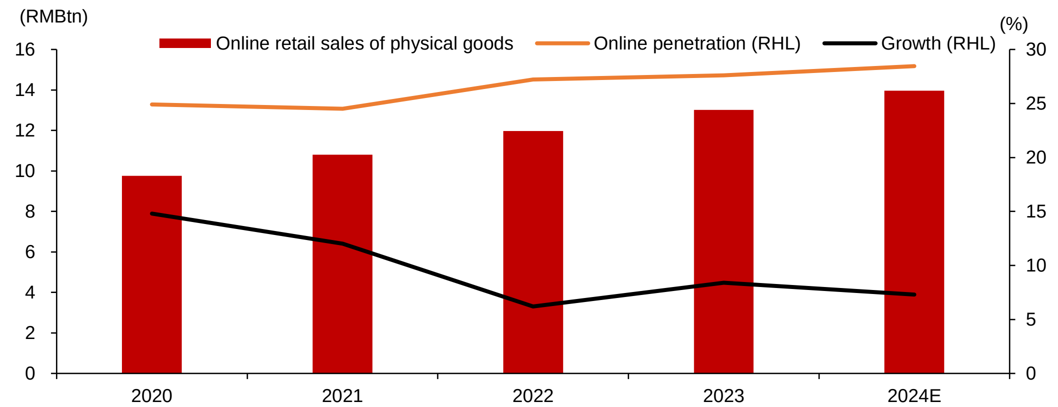



Source: NBS, CMBIGM

For the full year, the overall consumption recovery may still face challenges. In the near term, the focuses will be on actual implementation and sustainability of consumption promotion measures. The long-term consumption recovery on the back of fading risks from the property sector is still the key driving force for the sector's valuation in the mid- to long-term.

Per the National Bureau of Statistics (NBS), the online retail sales of physical goods in 8M24 was RMB8.0tn, up 8.1% YoY (7M24: 8.7%; 8M23: 9.5%). Based on the data, we estimate that the online retail sales of physical goods in August increased by 4.1% (2M24/March/April/May/June/July 2024: 14.4/6.8/9.6/12.9/-1.4/8.1%). The growth rate normalized after the 618 Shopping Festival, but receded again in August. In 8M24, online retail sales of physical goods accounted for 25.6% of the total retail sales of consumer goods (8M23: 26.4%; 7M24: 25.6%). Based on Wind consensus estimates of 4.1% for total retail sales of consumer goods in 2024, we trim our forecast for the full-year growth of online retail sales of physical goods to 7.3% (previous: 8.4%).

**Figure 20: China: online retail sales GMV of physical goods and growth forecast**




Source: NBS, CMBIGM estimates

- **Livestreaming e-commerce may bring smaller threats to traditional shelf e-commerce**

Based on our observation, the YoY growth rate of the overall livestreaming e-commerce GMV showed a decelerated trend QoQ, which may lessen the competitive impact on traditional shelf e-commerce. Per Latepost and Analysys, Douyin's e-commerce GMV rose 60%+/<40%/<30%/20%+ in 2M24/March 2024/April-May 2024/618 Shopping Festival, showing decelerated growth over the months. Kuaishou's e-commerce GMV growth was also weaker-than-expected, with 1Q24 and 2Q24 GMV growing by 28% and 15% YoY respectively. The growth rate of GMV in 2Q was weaker than market consensus of 24%. In our view, the slowdown of livestreaming e-commerce may be attributable to: 1) greater impact on impulsive buying amid weak consumption sentiment; 2) the user traffic of and user time spent on livestreaming e-commerce have gradually peaked (the supportive measures for merchants may not be able to continue if there is a lack of growth in user traffic); 3) weaker-than-expected user mindshare cultivation for the shelf e-commerce business of the livestreaming e-commerce platforms with a lack of infrastructure; and 4) relatively high traffic costs, making it difficult to support the implementation of low-price strategies and compete with peers.

- **E-commerce companies exhibited high ROI standard and discipline, not overly concerned on intensifying competition**

In terms of 2Q24 results of e-commerce players, although leading e-commerce platforms have previously guided for investments in improving user experience and driving GMV growth, leading companies are more focused on ROI, stratified operations of consumers (such as focusing on core member groups, activating old customers and increasing frequency), as well as attracting user traffic and enhancing supply chains to optimize platforms' quality/price ratios and cost effectiveness and promote efficient growth. Therefore, we have not noticed any inefficient competition without the consideration of benefits, and the profit performance of key domestic e-commerce platforms was better than market expectations. Looking ahead to 2H24, under the current macro environment, inefficient new customer acquisition and retaining existing customers through subsidies may not be efficient operating strategies. On PDD's earnings call, although management expected that further investments in the future may erode profitability which may trigger market concerns, we are of the view that more investments may flow into international business under its ROI target. Hence, we are not overly concerned on the deterioration of the competitive landscape.

In terms of 2Q24 results, JD.com's retail profit was better than market expectations (mainly due to lower-than-expected marketing and sales expenses under the stricter ROI requirement). Alibaba Taobao & Tmall Group's adjusted EBITA only fell by 1% YoY (better than market expectations) after investing in improving user experience and replacing part of equity incentives with long-term cash incentives. PDD's overall profit was also better than market expectations (we estimate that in addition to the better-than-expected reduction in losses in the international business, the better-than-expected profitability of the domestic e-commerce main business partly contributed to the result). Kuaishou did not give aggressive growth guidance for e-commerce in 2H24 amid weaker-than-expected 2Q GMV. We expect its 3Q-4Q e-commerce GMV growth to remain largely unchanged as that in 2Q, indicating that the company is still pursuing a higher ROI in its business operations, instead of making ineffective investments to restore GMV growth under macro headwinds.

- **Stable profit and enhanced shareholder return may bolster valuation**

With a relatively stable profit, e-commerce platforms may provide support for valuation by improving shareholder return. Apart from PDD, Alibaba and JD.com are committed to continuously improving shareholder return. 1) Alibaba: In 2Q24 (i.e. 1QFY25, fiscal year ends in March), it repurchased 77mn ADSs totaling US$5.8bn, and the total number of shares repurchased and cancelled accounted for 2.3% of the number of outstanding shares as of 31 March 2024. 2) JD.com: i) For the three months/six months ended 30 June 2024, the total number of shares repurchased by JD.com was approximately 4.5%/7.1% of the total number of common shares as of 31 March 2024/31 December 2023; ii) On 27 August

2024, the company unveiled a new three-year repurchase program of up to US$5.0bn worth of its shares, representing 4.4% of its current market value.

- **E-commerce service provider: multi-channel expansion with narrower losses**

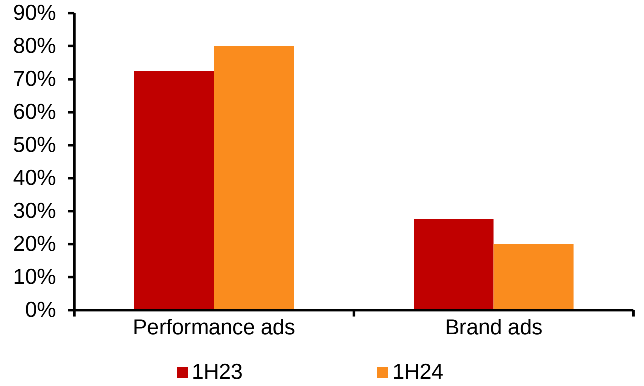
Baozun’s (9991 HK) total revenue came in at RMB2.4bn in 2Q24, up 3% YoY, driven by a 9% YoY increase in service revenue. Non-GAAP attributable net loss was RMB3.9mn, narrowing from RMB4.4mn loss in 2Q23, better than the market consensus of RMB16.6mn in loss. Baozun E-Commerce's (BEC) operating revenue swung to growth YoY after declining for 10 straight quarters. Management is of the view that such trend will be persistent in 2H24, benefiting from vigorious growth in Douyin-related businesses (accounting for about 5% of BEC's revenue, but saw a three-digit rise YoY), and the launch of agency distribution services. Although the weakening of overall offline traffic may affect the loss reduction trajectory of Baozun Brand Management (BBM), management has noticed signs of improvement, with GAP business revenue growth turning positive YoY in August 2024, and BEC's potentially better-than-expected operating profit may buffer BBM's larger-than-expected losses. Baozun is still endeavouring to achieve a narrower loss in 2024.

## Online advertising: ad budget continues to tilt towards leading platforms with high ROI

The growth of the online advertising industry may slow down in 2H24 amid weak macro and consumption environment, but the performance of different platforms may vary. Advertising budgets tend to further tilt towards leading platforms with high-ROI advertising solutions. The growth of advertising revenue of short- and mid-form video platforms may remain resilient, while that for traditional social media and search platforms may be under pressure. Looking ahead, we expect Tencent/Kuaishou/Bilibili's advertising business performance to continue to outperform (+13/19/25% YoY) in 2H24, mainly due to the continued improvement of advertising commercialization infrastructure, the continued growth of e-commerce related advertising revenue, and the incremental advertising budget contribution from verticals such as mini games and short dramas.

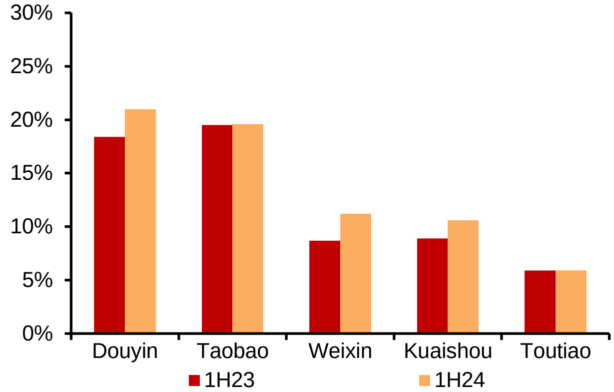
Per QuestMobile data, the proportion of performance-based advertising budgets in 1H24 rose by 7.6ppt YoY to 80.0%. Advertisers pay more attention to advertising ROI and conversion effects amid weak consumer sentiment. In 1H24, the proportion of leading short-form video and social media advertising budgets further increased, and the advertising budget of Douyin/Weixin/Kuaishou increased by 2.6/2.5/1.7ppt YoY to 21.0/11.2/10.6%. The combined share of the top five platforms increased by 6.9ppt YoY to 68.3%.

**Figure 21: China: online advertising revenue by formats**




Source: QuestMobile, CMBIGM

**Figure 22: China: online advertising revenue by media**




Source: QuestMobile, CMBIGM

1) In 2Q24, Tencent's revenue from online advertising rose 19% YoY to RMB29.9bn, mainly thanks to the robust growth of advertising revenue from Video Accounts and long-form videos but partly offset by decreasing revenue from ad network revenue. Video Accounts ad revenue grew by 80%+ YoY in 2Q24, due to growing user engagement and strong demand for livestreaming promotions. Looking ahead in 2H24, in order to foster the development of the e-commerce ecosystem on the Weixin platform, Video Accounts will further increase advertising inventory, help small and medium-sized businesses on the platform to obtain traffic while driving the advertising revenue of Tencent. We expect Tencent's advertising revenue to increase by 13% YoY in 2H24.

2) In 2Q24, Bilibili delivered ad revenue growth of 30% YoY to RMB2.0bn, driven by strong growth of performance-based ads. Supported by the upgrade of ads placement system and improvement of conversion capabilities, the number of advertisers grew by over 50% YoY in 1H24. Looking ahead, leveraging the continuous improvement of advertising commercialization infrastructure and increase in advertising conversion efficiency, we expect Bilibili's advertising revenue to grow 25% YoY in 2H24.

3) Kuaishou's online marketing revenue grew by 22% YoY to RMB17.5bn in 2Q24, driven by solid growth of both external and enclosed loop marketing services. External marketing services revenue YoY growth rate accelerated in 2Q24, mainly supported by strong demand from media, e-commerce and local services industries. Looking ahead, given the continued recovery of external loop marketing services and robust growth of enclosed loop marketing services, we anticipate Kuaishou's online marketing services revenue to rise 19% YoY in 2H24.

### Figure 23: China: online ad market quarterly revenue trend

| Ad revenue (RMBmn) | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | 3Q23 | 4Q23 | 1Q24 | 2Q24 |
|---|---|---|---|---|---|---|---|---|---|---|
| Tencent | 17,988 | 18,638 | 21,443 | 24,660 | 20,964 | 25,003 | 25,721 | 29,794 | 26,506 | 29,871 |
| Baidu | 15,592 | 17,074 | 18,696 | 18,018 | 16,568 | 19,586 | 19,672 | 19,154 | 17,008 | 19,164 |
| Kuaishou | 11,352 | 11,006 | 11,589 | 15,094 | 13,064 | 14,347 | 14,690 | 18,203 | 16,650 | 17,515 |
| Meituan | 7,019 | 7,317 | 8,663 | 8,138 | 7,783 | 10,307 | 11,439 | 10,159 | 9,877 | 12,360 |
| Xiaomi | 4,500 | 4,500 | 4,700 | 4,700 | 4,400 | 5,100 | 5,400 | 4,913 | 5,131 | 6,000 |
| Weibo | 2,708 | 2,583 | 2,695 | 2,734 | 2,434 | 2,731 | 2,784 | 2,911 | 2,474 | 2,702 |
| BiliBili | 1,041 | 1,158 | 1,355 | 1,512 | 1,272 | 1,573 | 1,638 | 1,929 | 1,669 | 2,037 |
| Autohome | 1,471 | 1,733 | 1,843 | 1,893 | 1,534 | 1,833 | 1,906 | 1,911 | 1,609 | 1,873 |
| iQIYI | 1,337 | 1,194 | 1,247 | 1,554 | 1,404 | 1,495 | 1,674 | 1,651 | 1,482 | 1,461 |
| **YoY** | **1Q22** | **2Q22** | **3Q22** | **4Q22** | **1Q23** | **2Q23** | **3Q23** | **4Q23** | **1Q24** | **2Q24** |
| Tencent | -17.6% | -18.4% | -4.7% | 14.6% | 16.5% | 34.2% | 20.0% | 20.8% | 26.4% | 19.5% |
| Baidu | -3.6% | -10.1% | -3.6% | -5.5% | 6.3% | 14.7% | 5.2% | 6.3% | 2.7% | -2.2% |
| Kuaishou | 32.6% | 10.5% | 6.2% | 14.0% | 15.1% | 30.4% | 26.8% | 20.6% | 27.4% | 22.1% |
| Meituan | 23.9% | 1.4% | 8.0% | -0.6% | 10.9% | 40.9% | 32.0% | 24.8% | 26.9% | 19.9% |
| Xiaomi | 15.4% | 0.0% | -2.1% | -4.1% | -2.2% | 13.3% | 14.9% | 4.5% | 16.6% | 17.6% |
| Weibo | 5.6% | -20.9% | -22.9% | -22.1% | -10.1% | 5.7% | 3.3% | 6.5% | 1.7% | -1.0% |
| BiliBili | 45.6% | 10.4% | 15.6% | -4.7% | 22.2% | 35.8% | 20.9% | 27.6% | 31.2% | 29.5% |
| Autohome | -20.1% | -10.6% | 4.5% | 11.8% | 4.2% | 5.8% | 3.4% | 1.0% | 4.9% | 2.2% |
| iQIYI | -30.2% | -34.6% | -24.9% | -6.7% | 5.0% | 25.3% | 34.3% | 6.2% | 5.6% | -2.3% |

Source: Company data, CMBIGM

### Figure 24: China: online ad market quarterly revenue trend

| (RMBbn) | 2021 | 2022 | 2023 | 2024E | 2025E |
|---|---|---|---|---|---|
| **China retail sales** | **44,082** | **43,973** | **47,150** | **49,601** | **51,982** |
| YoY | 13% | 0% | 7% | 4% | 5% |
| **China online physical good sales** | **10,804** | **11,964** | **13,017** | **14,110** | **15,169** |
| YoY | 11% | 6% | 8% | 7% | 8% |
| **Online ad market revenue** | **905** | **918** | **1,047** | **1,172** | **1,272** |
| YoY | 18% | 2% | 14% | 12% | 9% |
| **Social media & search – ad revenue** | | | | | |
| Tencent | 88.7 | 82.7 | 101.5 | 118.9 | 137.4 |
| Kuaishou | 42.7 | 49.0 | 60.3 | 73.3 | 84.5 |
| Weibo | 12.8 | 10.7 | 10.8 | 10.6 | 11.1 |
| iQIYI | 7.1 | 5.3 | 6.2 | 6.3 | 6.7 |
| BiliBili | 4.5 | 5.1 | 6.4 | 8.2 | 9.3 |
| Baidu | 73.6 | 69.4 | 75.0 | 74.3 | 79.7 |
| **E-commerce - ad revenue** | | | | | |
| Alibaba (CMR revenue) | 228.5 | 210.1 | 216.5 | 224.8 | 236.7 |
| Pinduoduo | 72.6 | 102.9 | 153.5 | 203.1 | 225.9 |
| JD.com | 46.9 | 57.7 | 61.4 | 68.9 | 72.0 |
| Meituan | 29.1 | 30.8 | 40.5 | 49.9 | 55.9 |
| **Social media & search – YoY** | | | | | |
| Tencent | 8% | -7% | 23% | 17% | 16% |
| Kuaishou | 95% | 15% | 23% | 22% | 15% |
| Weibo | 11% | -16% | 1% | -2% | 4% |
| iQIYI | 4% | -25% | 17% | 2% | 6% |
| BiliBili | 146% | 12% | 27% | 27% | 14% |
| Baidu | 12% | -6% | 8% | -1% | 7% |
| **E-commerce - YoY** | | | | | |
| Alibaba (CMR revenue) | 3% | -8% | 3% | 4% | 5% |
| Pinduoduo | 51% | 42% | 49% | 32% | 11% |
| JD.com | 49% | 23% | 6% | 12% | 4% |
| Meituan | 54% | 6% | 32% | 23% | 12% |

Source: NBS, company data, iResearch, CMBIGM estimates

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