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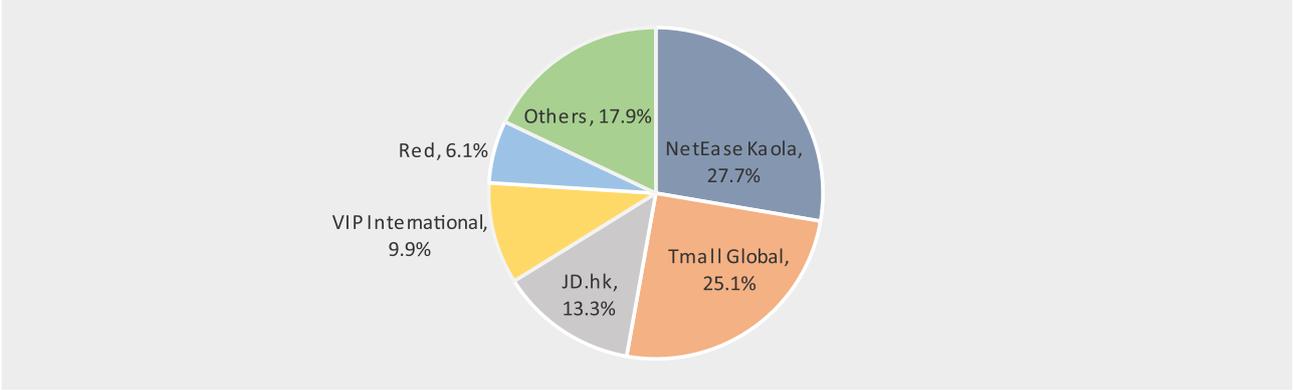
About the deal

On 5 September, Alibaba announced to fully acquire NetEase’s cross-border e-commerce (CBEC) platform NetEase Kaola for about US\$2 billion. NetEase Kaola will continue to operate independently under its current brand, with Tmall Import and Export General Manager Alvin Liu serving as NetEase Kaola’s new CEO. Alibaba, together with NetEase Kaola, will further elevate import service and experience for Chinese consumers through synergies across the Alibaba ecosystem.

About NetEase Kaola

NetEase Kaola, launched by NetEase in 2015, is one of the market leaders in the CBEC sector. According to domestic consulting agency iiMedia, NetEase Kaola ranked first in the CBEC import market in terms of transaction value with 27.7% market share in 1H19, followed by Tmall Global with 25.1% market share and JD.hk with 13.3% market share¹ (Exhibit 1).

Exhibit 1 CBEC (import) players by market share, 1H19



Source: iiMedia, compiled by Fung Business Intelligence

Different from Tmall Global which operates like a marketplace, NetEase Kaola focuses on both marketplace and self-operated model – sourcing goods directly from suppliers to resell to consumers. It imported more than 9,000 brands from 80 countries in 2018², ranging from luxury brands such as Gucci and Burberry to various well-known overseas brands and retailers including Sa Sa International Kao and Laox, and to niche brands and lesser known factory brands.

Recently in July 2019, NetEase Kaola signed a strategic cooperation agreement with Italian luxury goods company Salvatore Ferragamo, as well as a few baby product brands including Pigeon, b.box and Huggies (South Korea) to help them tap the China market.

NetEase Kaola has been keen to expand its offline presence over recent years. It set up two offline stores in Hangzhou and Zhengzhou respectively in April and August 2018. To further its O2O push, it launched its first offline flagship store in Hubin Yintai In77 in Hangzhou in January 2019. With a store area of 700 sqm, the store offers over 3,000 SKUs covering cosmetics, personal care products, baby and maternity goods, affordable luxury, digital products, etc. The products were selected according to the big data analysis from the customers ordered from NetEase Kaola platform, as well as the two offline stores in Hangzhou and Zhengzhou. Further, in April 2019, NetEase Kaola also opened its first offline “Global Factory Store” at Raffles City Shopping Centre in Hangzhou. With a store size of 200 sqm, the store offers 1,500 SKUs selected from its online “Global Factory Store”, ranging from cosmetics, personal care products, digital products, home electronics, food, home products and outdoor products.

In terms of logistics, NetEase Kaola has been investing proactively in its own distribution centers. In June 2019, NetEase Kaola opened a new cross-border intelligent bonded warehouse in Ningbo, its largest and most automated of the kind in China. The warehouse can store more than 60 million items, with a daily handling capacity of 300,000 CBEC orders. It is reported that currently, NetEase Kaola has set up a warehousing network covering 15 CBEC pilot zones and a majority of pilot cities with a total area of more than 1 million sqm of bonded warehouse resources³. NetEase Kaola formed alliance with property developer Vanke in January 2019 to cooperate in areas including warehouse operation, logistics and distribution, especially in the 22 new CBEC pilot zones⁴.

Comments from Fung Business Intelligence

NetEase Kaola and Tmall Global together will have the biggest market share of CBEC import market

NetEase Kaola and Tmall Global are China's largest and second-largest CBEC platform, respectively, holding 27.7% and 25.1% of the market in 1H19, and their tie-up means they will create a business that will far exceed rivals like JD.hk and VIP International and lead to market consolidation in the CBEC import market. Meanwhile, the marriage of the two companies can avoid hefty price wars between the two market leaders.

The deal will enable Alibaba to leverage resources of NetEase Kaola such as logistics and warehousing, as well as acquire customer data for better consumer insights

NetEase Kaola owns a number of logistics warehouses in 15 CBEC pilot zones. By acquiring NetEase Kaola, Alibaba can leverage these resources in its cross-border e-commerce businesses. Meanwhile, Alibaba can leverage NetEase Kaola's knowledge on consumer. They can work together to elevate experience for Chinese consumers shopping for overseas goods via CBEC platforms.

The deal will enable Alibaba to fend off competitions from all fronts

The acquisition not only enables Alibaba to gain more than half of the market share in the CBEC import market and outpace other competitors, but also allows it to better compete with Pinduoduo, which has reportedly expressed interests earlier in acquiring Kaola business to expand its cross-border presence⁵. Indeed, in response to competition from Pinduoduo, Alibaba has revamped Juhuasuan, its group-buying service and launched its private label retail site Taobao Xinxuan in 2017.

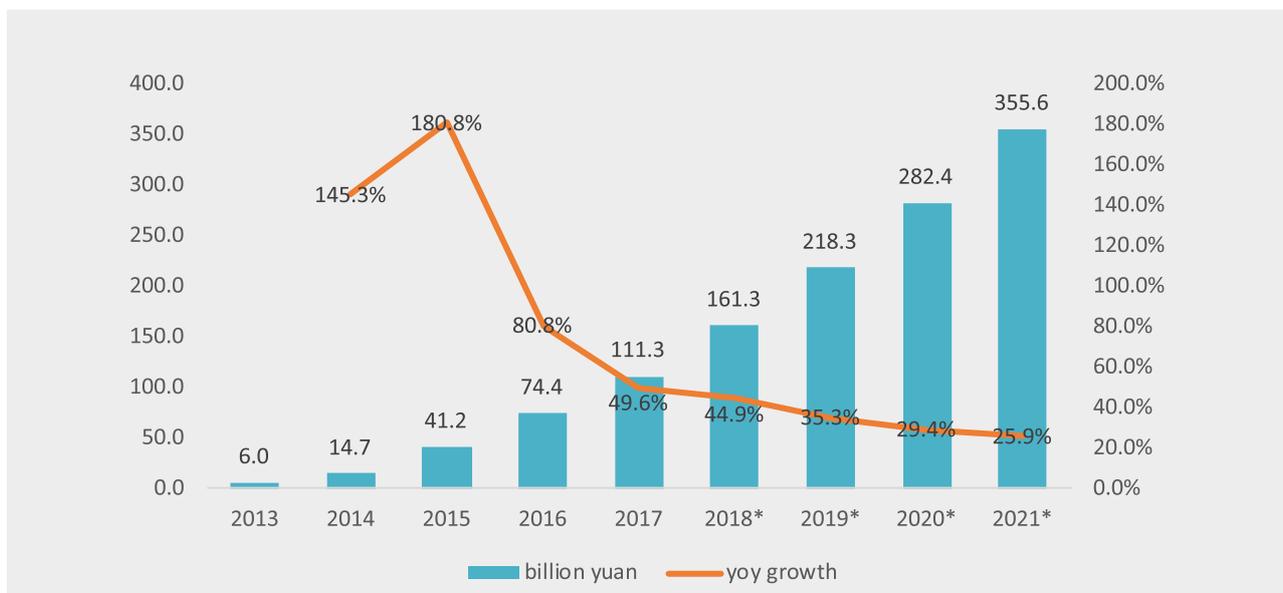
Selling Kaola platform will allow NetEase to focus on its gaming business

For NetEase, selling its low-margin Kaola platform will allow the company to focus on its gaming business. According to NetEase's annual report in 2018, its net revenues were 67.16 billion yuan in FY18, of which 40.19 billion-yuan revenues were generated by its online gaming businesses⁶. The gross profit margin for online game services for FY18 was 63.6%, comparing with e-commerce of just 8% (which includes e-commerce business of NetEase Kaola and NetEase Yanxuan). Shifting the focus of NetEase back to its major online gaming businesses would be a rational act for NetEase.

About cross-border e-commerce (import) market in China

China's CBEC (import) market has maintained stable development in recent years, fueled mainly by individuals upgrading their level of consumption. Chinese consumers are increasingly buying high quality and unique overseas products via approved CBEC platforms. Without a doubt, Chinese shoppers are the largest community buying products online from overseas. A report from eShopWorld showed that there are 149.42 million CBEC shoppers in China, comparing with 82.72 million in the U.S., and 53.02 million in India. According to iResearch, the transaction value of the CBEC (import) retail market increased by 44.9% year-on-year (yoy) to 161.33 billion yuan in 2018 and is expected to rise to over 350 billion yuan by 2021 (Exhibit 2). However, the growth of China's CBEC (import) market has been moderating in recent years.

Exhibit 2 Transaction value of CBEC (import) retail market, 2014-2021 (estimates)



Source: iResearch, compiled by Fung Business Intelligence

Currently, cross-border B2C players usually sell on two major types of platforms – integrated CBEC platforms in the form of marketplace platforms, self-operated platforms and hybrid platforms and vertical CBEC platforms which are often a combination of marketplace and self-operated platforms. The former sells a large variety of categories of products, while the latter focuses on a few specialized categories. Selected major CBEC platforms and their major operating models are shown in Exhibit 3.

Exhibit 3 Selected major CBEC platforms and their operating models

	Integrated CBEC platforms			Vertical CBEC platforms		
Player	Tmall Global	JD.hk	VIP International	NetEase Kaola	Xiaohongshu (Red)	Mia.com
Operating model	Marketplace	Marketplace and self-operated	Self-operated	Marketplace and self-operated	Marketplace and self-operated	Marketplace and self-operated
Core competencies	Wide product choices	Good logistics services	Good after-sale services	Mainly self-operated; authentic products	Content-based and community nature	Specialized in baby and maternity products

Source: iResearch, compiled by Fung Business Intelligence



"We are pleased to have found a strategic fit for Kaola within Alibaba's extensive ecosystem, where Kaola will continue to provide Chinese consumers with high-quality import products and services. At the same time, the completion of this strategic transaction will allow NetEase to focus on its growth strategy, investing in markets that allow us to best leverage our competitive advantages."

William Ding, Chief Executive Officer of NetEase



"Alibaba is confident about the future of China's import e-commerce market, which we believe remains in its infancy with great growth potential... With Kaola, we will further elevate import service and experience for Chinese consumers through synergies across the Alibaba ecosystem."

Daniel Zhang, Chief Executive Officer of Alibaba Group

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Contacts

Asia Distribution and Retail

Teresa Lam
Vice President
E: teresalam@fung1937.com

Christy Li
Senior Research Manager
E: christyli@fung1937.com

Fung Business Intelligence

10/F LiFung Tower
888 Cheung Sha Wan Road
Kowloon, Hong Kong
T: (852) 2300 2470
F: (852) 2635 1598
E: fbicgroup@fung1937.com



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