

Case study analysis of a recent acquisition of Alibaba group and Kaola.com

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Abstract: Alibaba Group, as one of the leaders in the adoption of e-commerce business model in China and even in the world, many of its transaction behaviours have been analyzed to obtain more business enlightenment. Kaola.com also has considerable influence as an e-commerce platform that implemented membership system earlier in China. This research would analyze the high-profile acquisition between these two companies, aiming to analyze the motivation of this acquisition and its impact on the acquirer, Alibaba group, and the acquiree, Kaola.com. Through this case analysis, it is obvious that this acquisition could be regarded as a friendly acquisition, and the companies involved in this acquisition had achieved healthy and sustainable development.

Keywords: Acquisition, Motivation, Defensive Strategies, Alibaba Group, Kaola.com

1. Introduction

1.1 Brief introduction of the companies

1.1.1 Acquirer: Alibaba Group (Ali)

Ali was founded in 1999 in Hangzhou, China. And it was officially listed on NYSE on September 19, 2014, and created the world largest IPO (Baker, *et al.*, 2014)^[4]. And by 2018, it has been the second-largest company in Asia (JAO, 2018)^[8]. Moreover, it not only operates several businesses but also gets support from its affiliated companies.

According to its website its businesses and affiliated companies include Taobao (comprehensive C2C online shopping platform), Tmall Global (cross-border exchanging platform (B2C)), AliExpress (called the international version Taobao), 1688 (focusing on wholesale and procurement business), Alibaba International Trade Site (helping the users find quality exporters, importers and products from the website), Ant financial services group (based on Alipay and providing Internet financial services), Cainiao Network Technology Co., Ltd (building open and socialized logistics infrastructure throughout China), Alibaba Cloud Computing Co., Ltd (focusing on cloud computing and AI technology), Xiaohongshu (leading the investment in May 2018), etc.

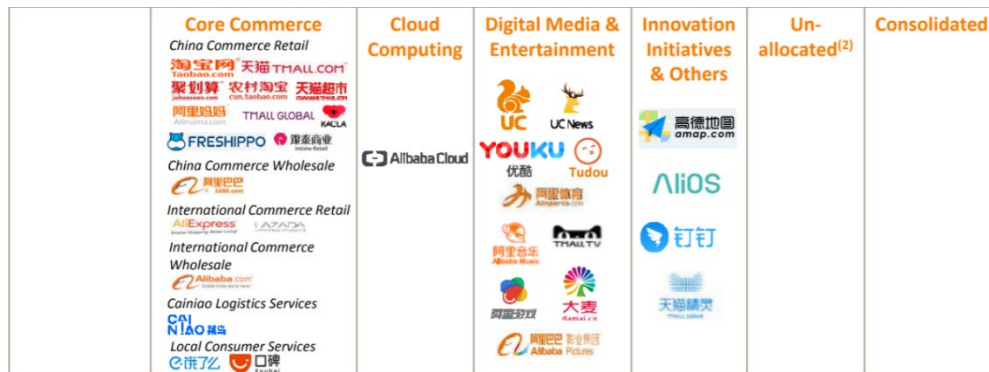
1.1.2 Acquiree: NetEase Kaola (Kaola)

Kaola is a comprehensive e-commerce business launched by NetEase on January 9 in 2015, which mainly focuses on cross-border business. And it is also a strategic product created by NetEase group and invested a lot of superior resources. The sales category of Kaola covers mother and child, beauty and cosmetics, gourmet, nutrition and health care, home care, light luxury fashion, 3C digital, etc. About the NetEase Group mentioned above, which is one of the largest Internet and video games companies, founded in 1997, in the world, according to the information provided by the VentureBeat website in 2017^[19]. And it was successfully listed on Nasdaq in 2000.

It is worth mentioning that Kaola mainly adopts a self-operated mode (SUN, *et al.*, 2018)^[15]. Relying on NetEase group's strong financial support, worldwide branches, huge high-quality users, abundant media resources and brand promotion advantages and professional purchasing team, Kaola could reach the origin of overseas products and connect with overseas brand owners and dealers. Finally, Kaola forms the B2C sales mode and could attract more overseas brand owners to establish a deep partnership (Gui and Li, 2018)^[15].

1.2 Brief introduction of the acquisition event

On September 6, 2019, NetEase and Ali jointly announced that Ali confirmed the acquisition of Kaola for 2 billion dollars and integrated Kaola into Tmall Global (techcrunch.com, 2019)^[1]. And Kaola could remain the operation as an independent autonomous unit (cnbc.com, 2019)^[2]. Moreover, Mr. Alvin Liu, the general manager of the Tmall import and export business group, would serve as the CEO of Kaola. And NetEase did not shown hostility to the acquisition. (Shi, 2019)^[18]. Besides, NetEase Cloud Music received 700 million dollars in financing from Ali. This means that Ali would own part of the stake of this media platform and use its influence to serve the future strategic layout. After the acquisition, the layout of Ali's core businesses was shown below in Figure 1.



Source: Ali's Sept. 2019 quarterly report

Figure 1: The layout of Ali's core businesses

2. Motivation analysis of the acquisition

2.1 Ali's acquiring motivation

2.1.1 To increase market share

Ali intended to increase the market share of Tmall Global, mentioned above, in China's total cross-border import market by acquiring Kaola. Generally, the increase in market share could improve sales volume. And then the absolute profit of the company may be improved if the profit margin of a single product is not reduced or the reduction degree is less than the sales growth degree. Finally, the profit structure could be optimized (Roberts, et al., 2017)^[17]. Kaola had a market share of 27.7 percent in the first half of 2019, ranking first in China's total cross-border import market, and Tmall's international market share at this time was only 25.1 percent (Wang, et al., 2020)^[22]. After the completion of the acquisition, the market share of Ali's imported e-commerce module would exceed 50%. As a result, Tmall's competitive position in the whole cross-border import market would have a significant improvement, which would form an obvious scale advantage compared with other competitors. Accordingly, its profitability would also be improved. And the detailed increase in profitability will be analyzed in the outcome section.

2.1.2 To strengthen existing business and achieve the procurement target

Ali needs to massively expand the operating scale of cross-border procurement, to achieve the target of 200 billion dollars cross-border procurement in the next five years, which was announced at the first China International Import Expo in 2018. In this case, it seems to be more cost-effective for Ali to acquire an existing mature cross-border e-commerce platform than to invest in a new one. The acquisition would be usually divided into vertical, horizontal and conglomerate (Lan, et al., 2019)^[11]. When an acquirer's motivation is to obtain future growth opportunities and expand its operations in a particular industry, an important strategy would be to conduct horizontal acquisitions of existing companies in its industry, rather than merely relying on internal development (Hovenkamp and Shapiro, 2017)^[7]. Through this horizontal acquisition, directly, Ali would own Kaola, a mature cross-border e-commerce platform, gain time advantage and avoid the time delay problem that might be caused by the investment in the new platform. Thus, the acquisition could increase the possibility of completing the cross-border procurement target within 5 years.

2.1.3 To form complementary advantages in business

As for the products, to some extent, Kaola, which started with maternal and child products (chinainternetwatch.com, 2020)^[9], could complement each other in a product category with Tmall Global, which mainly focuses on beauty makeup, properly. Besides, Tmall Global is positioned as a 'new product debut', good at first-tier brands (alizila.com, 2019)^[20], while Kaola focuses on second and third-tier brands. The effective integration of both sides could form complementary advantages in product categories.

What's more, Ali also invested \$700 million in NetEase CloudMusic during the acquisition. Ali would make use of this media platform to do more publicity work and increase the traffic of each platform. Therefore, the acquisition of Kaola could not only help Tmall consolidate its dominant position in the industry but also obtain new operating resources to expand the operation scale to achieve the strategic goal of 200 billion dollars.

In addition, Ali could take advantage of the huge number of Kaola's users, as well as offline stores to expand its business models (LI, 2016)^[14]. As of July 2019, Kaola had 9,352,700 monthly active users, according to 'Dianshubao' database. After the acquisition, Ali would directly enjoy the benefits brought by this huge and stable consumer group. Furthermore, Kaola has opened some offline stores in the past few years (sina.com, 2019)^[3]. These offline stores could increase users' consumption experience and promote ordering in some ways. In summarize, this may be an opportunity for Ali to start a new business model of O2O to improve its competitive power and this is a great help for Ali's ongoing offline expansion and new retail integration.

2.2 Motivation for Kaola to be acquired

2.2.1 To obtain the support of mature supply chain technology

Through this acquisition, Kaola intends to obtain more support for the supply chain that Ali already has. A mature supply chain system could improve the operation efficiency and profit benefit of the whole company to a certain extent (Daneshvar, et al., 2020)^[6]. Kaola's concept of "self-operation" has put heavy cost pressure on it. As an overseas online shopping platform, Kaola has been developing its warehouses in overseas and domestic bonded areas, and it has established its purchasing team to procure goods personally. However, its supply chain seems to be still fragile. As a result that it only solves the warehouse problem, but it is unable to make a voice in the source link. In detail, it cooperates with dealers around the world, and the goods provided by dealers are not always authentic, depending on the personal qualities of the distributor. It is hard for Kaola to control this subjective point. For example, Kaola's reputation was badly damaged by the Estee Lauder scandal in February 2018 and the fake goods of Canada Goose at the end of the same year. What is worth mentioning, Kaola's intention to acquire Amazon China in the first half of 2019 is most likely to solve the problem of the uncertain supply (Zheng, 2019)^[23]. By contrast, Tmall's sources are more reliable, because of the direct cooperation with manufacturers to ensure the quality of goods. Therefore, after being acquired, Kaola could also use this superior resource to get more speaking right in the field of the source of the supply chain.

Moreover, Kaola would also get assistance in other parts of the supply chain. Effective supply chain management not only controls the quality of goods in the procurement process but also aims to provide efficient logistics, warehousing, finance and other services to reduce the total cost and improve the management efficiency of the company. In the logistics stage, Ali's Cainiao network would connect with Kaola's bonded warehouses in various places, and Kaola could make use of this to provide better logistics and distribution services for consumers. Besides, Ali's Ant Financial Service would provide Kaola with more financial services. Specifically, differed from other cross-border e-commerce platforms, Kaola has its factories to produce products (called NetEase hand-picked goods), but its previous operations ignored the competitive advantage of exporting these self-produced goods. Nevertheless, Ali's cross-border e-commerce includes import and export, and the Ali International trading platform mentioned earlier is a good example. Therefore, in terms of cross-border export, Kaola would have the chance to develop its own export business by making use of the mature import and export trading platform provided by Ali.

In short, Kaola could acquire a lot of resources from Ali through this acquisition, so as to build a more reasonable supply chain system.

2.3 NetEase. Inc's motivation to sell Kaola

2.3.1 To get rid of low-margin division and maintain revenue growth

Table 1: Profit data of NetEase from 2014 to 2016

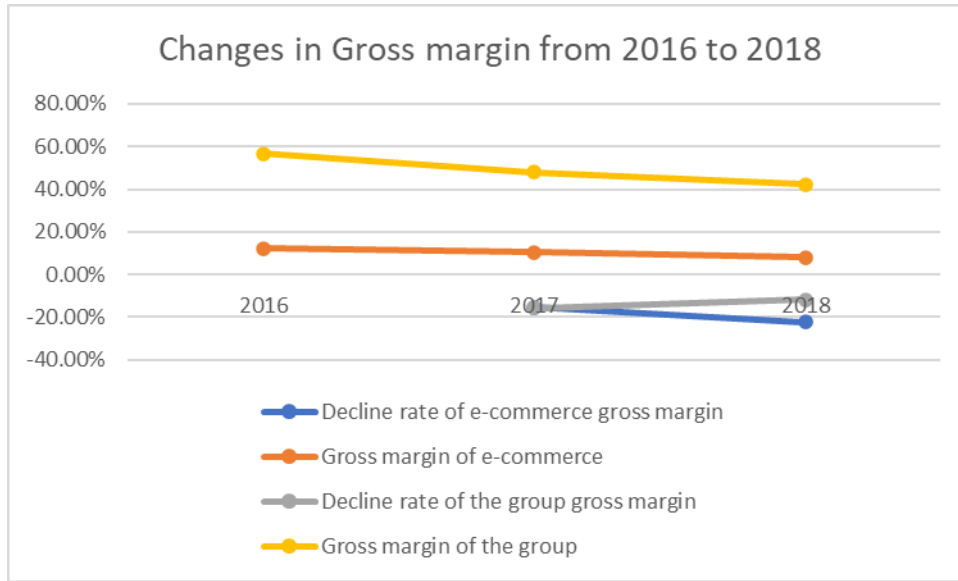
Source: NetEase's annual reports

	For the year ended December 31		
	2014	2015	2016
	RMB	RMB	RMB
data for segment			
Revenue of E-mail, e-commerce and others	1,101,847	3,699,370	8,045,974
Cost of E-mail, e-commerce and others	-631,152	-3,406,673	-5,791,234
Gross profit of e-mail, e-commerce and others	470,695	292,697	2,254,740
Gross margin	42.72%	7.91%	28.02%
data for group			
Total net revenues	11,712,834	22,802,895	38,178,844
Total cost of revenues	-3,261,544	-9,399,260	-16,515,032
Total gross profit	8,451,290	13,403,635	21,663,812
Gross margin	72.15%	58.78%	56.74%
Net income per share, diluted	1.45	2.04	3.51

Table 2: Profit data of NetEase from 2016 to 2018

Source: NetEase's annual reports

	For the year ended December 31		
	2016	2017	2018
	RMB	RMB	RMB
data for segment	3.51	3.23	1.89
Revenue of e-commerce	4,541,744	11,670,416	19,235,476
Cost of e-commerce	-3,986,871	-10,464,714	-17,688,717
Gross profit of e-commerce	554,873	1,205,702	1,546,759
Gross margin	12.22%	10.33%	8.04%
data for group			
Total net revenues	38,178,844	54,102,019	67,156,453
Total cost of revenues	-16,515,032	-28,189,326	-38,752,957
Total gross profit	21,663,812	25,912,693	28,403,496
Gross margin	56.74%	47.90%	42.29%
Net income per share, diluted	3.51	3.23	1.89



Source: NetEase's annual reports

Figure 2: Changes in Gross margin in NetEase from 2016 to 2018

By separating the growing but losing e-commerce division, NetEase will be able to focus more on its core gaming business. Particularly, the government of China allows new online games to charge now (Wang, 2019)^[21]. It can be seen clearly from Table 1 that after launching the Kaola, the first overseas shopping business of NetEase, in 2015, directly boosted the revenue of e-mail, e-commerce and others. However, due to the high costs of sales for promoting the e-commerce platform, Kaola, according to the information from annual reports, the gross margin of this part was not high. What's more, the gross margin of this part was much lower than the margin of the group, so it may cause the phenomenon of pulling down the gross profit margin of the whole group. With the development of e-commerce business, since 2017, the profitability of the e-commerce segment has been separately disclosed in the notes section. As can be seen from the data in Table 2, although the revenue of e-commerce had increased sharply, the gross margin of it showed a downward trend year by year and less than the gross profit margin of the group. From Figure 2, although the company's gross profit margin was also decreasing, the e-commerce part of the decline rate was greater. Moreover, due to the sharp reduction of gross profit margin, net income was also not high, then affecting the net profit rate per share. Therefore, to prevent the poor company performance and loss of shareholders' wealth, NetEase chose to sell the e-commerce business, Kaola, with weak profitability and low gross profit margin.

3. Payment method in this acquisition event

Table 3: The consideration of Ali's acquisition of Kaola

Source: Ali's annual report

The consideration of Ali's acquisition of Kaola				
				Amounts
				(¥ m)
Total purchase consideration is comprised of:				
- cash				10,025
- share				2,252
- contingent consideration				1,049
Total				13,326

The specific information of Alibaba's consideration payment for the acquisition of Kaola is shown in the above Table 3, which involves cash consideration, share consideration and contingent consideration.

For cash consideration, it seems to be simple and clear. For the acquirer, the cash payment method requires the enterprise to raise a large amount of cash in a short time, which may bring great pressure to the operation of Ali and affects its ability of liquidity. For Kaola, it could meet their need to get cash flow as quickly as possible. What's more, when capital gains could not be recognized later, taxes would

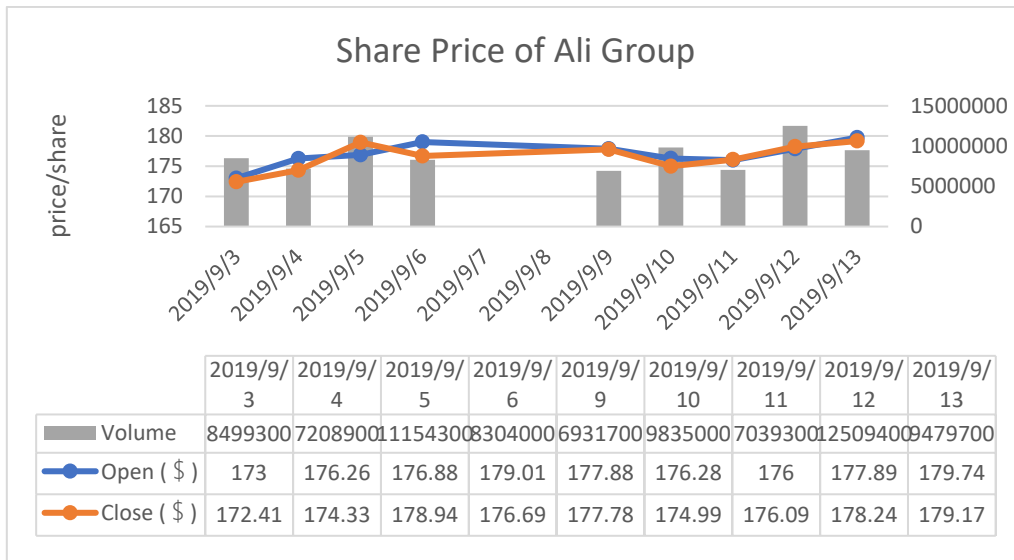
be paid earlier and the tax benefits would not be available. Therefore, there will be a heavy tax burden involved in Kaola.

For the share consideration, perhaps the biggest problem with it is the dilution of the acquirer's stake. However, for NetEase, the shareholder would not lose the equity of this part's stock, but would lose the corresponding control right.

For contingent consideration, it means that this is a cash consideration about ¥846 million that is subject to the koala's full compliance with the non-compete agreement. This protects the company's cross-border business from the threat of hostile competition and controls the final total consideration to protect the interests of the company and its shareholders.

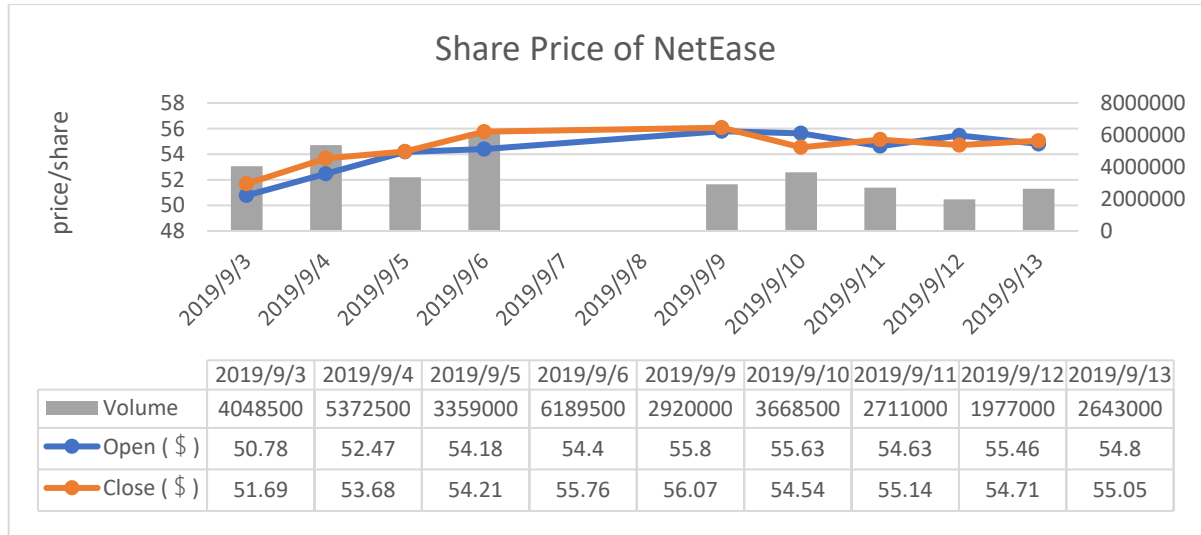
4. Analysis of share price change during the announcing period

Figure 3 and Figure 4 show the movements of share prices of Ali and NetEase during the acquisition period. As Ali acquired Kaola mainly with cash, the share price fell slightly, after the announcement of the acquisition on September 6th. And because part of the acquisition consideration was paid for by issuing new shares, the existing shareholders' equity was diluted to some extent. Therefore, the wealth of shareholders declined. The reasons for the decline may be varied, two of which are likely to be the following. First, the acquisition was reached mainly by cash, this seems to be a large cash outflow for Ali, which makes the cash flow of Ali suffer unregular fluctuations in short term. Second, Ali acquired Kaola 100 percent, so Kaola's debt transferred to Ali. Both of these factors might make investors lose some confidence, which should be reflected in the stock market as share prices fall. For NetEase, after the acquisition, a large cash inflow could adequately support NetEase's operations. The market seems to give positive feedback on this large cash inflow, and NetEase's share price rose by 2.86%, so a higher share price means more wealth for the group shareholders.



Source: Ali's annual report

Figure 3: Share Price of Ali Group



Source: Ali's annual report

Figure 4: Share Price of NetEase

5. The outcome of this deal for the acquirer

5.1 Decreasing non-systematic risk

After this deal, the non-systematic risk of Ali shareholders' portfolio has been decreased. The obvious feature of non-systematic risk is that diversification is one of the effective ways to eliminate non-systematic risk (Buchner, et al., 2017)^[5]. After this acquisition, the business scope of the company will be broader, including first-tier, second-tier and third-tier brands and more product categories, as mentioned above. Compared with the previous business scope, it could effectively diversify investment and reduce the non-systemic risks faced by shareholders.

5.2 Implementing defensive strategies against competitors

Judging from the current development of China's major e-commerce platforms, Ali's two biggest competitor may be Pinduoduo.Inc and JD.com (Kharpal, 2020)^[10].

The core competitive advantage of JD is the same-day delivery and next-day delivery service realized by its own warehouses combined with its own logistics distribution (Liu, 2019)^[13]. For this, Ali already had established Cainiao network to contend with it.

Pinduoduo's biggest threat to Tmall is that its business is gradually becoming like Tmall. After Pinduoduo was listed in Shanghai and New York on July 26, 2018 (Laubscher, 2018)^[12], it released two targeted investment advertisements on July 31, covering almost 500 mainstream brands, including second and third-tier sportswear and various furniture brands; on August 31 its app was also upgraded and revised, and the platform entrance with the words "Brand Pavilion" appeared in the center of the homepage, distinguishing it from ordinary stores (new.qq.com, 2018)^[15]. So far, Pinduoduo has developed its low-price advantage and possessed the characteristics of Tmall's 'brand sales' (marketingtochina.com, 2019)^[16], which posed a great threat to Tmall. While Tmall previously focused on the sales of first-tier brands, Kaola focused on the second and third-tier brands. Then, after acquiring Kaola, Ali has expanded its product coverage and increase the sales of second-and third-line brand products; at the same time, it also realized online sales of home building materials through the Kaola factory to counter the pressure brought by Pinduoduo.

In short, after the completion of the acquisition, Ali could form a reasonable and efficient operation chain as 'Tmall Global and Kaola mainly focus on the high-quality goods and strengthen the self-operation; Little Red book focus on incubating new brands; and Taobao Live Assist the sale.' to consolidate its leading position in the e-commerce platform.

5.3 Increasing Ali's profitability and the wealth of shareholders in a long run

Table 1: Retail Revenues in 2019 of Ali

Source: Ali's quarterly reports

China commerce retail revenue during acquisition					
Three months ended June 30, 2019					
China commerce retail revenue:			RMB MM	% of total revenue	year of year %
customer management			41954	37%	27%
commission			16902	15%	23%
others			16745	14%	134%
total revenue of this part:			75601	66%	40%
Jun Q19 adjusted EBITA (MM) for core commerce:			RMB MM	41025	
			US\$	5976	
year of year %				41%	
growth rate to the previous quarter					-
Three months ended September 30, 2019					
China commerce retail revenue:			RMB MM	% of total revenue	year of year %
customer management			41301	35%	25%
commission			16275	14%	24%
others			18210	15%	125%
total revenue of this part:			75786	64%	40%
Sept Q19 adjusted EBITA (MM) for core commerce:			RMB MM	38574	
			US\$	5397	
year of year %				38%	
growth rate to the previous quarter				-5.97%	
Three months ended December 31, 2019					
China commerce retail revenue:			RMB MM	% of total revenue	year of year %
customer management			61235	38%	23%
commission			23409	14%	16%
others			25814	16%	128%
total revenue of this part:			110458	68%	36%
Dec Q19 adjusted EBITA (MM) for core commerce:			RMB MM	58075	
			US\$	8342	
year of year %				41%	
growth rate to the previous quarter				50.55%	

First, it is necessary to know that China commerce retail is included in core commerce; and 'others', in Table 4, are from New Retail and direct sales businesses, such as Freshippo, Tmall Supermarket, direct import and Intime. So Kaola's revenue belongs to this part, according to Ali's quarterly report. Then, it is obvious from the above Table 1 and 2 that after the acquisition of Kaola on 6 September, in 2019, the absolute value of other revenue increased for two consecutive quarters, and the proportion of total revenue also continued to increase, which led to the continued growth of the revenue of the retail business in China. As for the core business, its EBITA increased significantly in December despite a decline on September 19, which is inseparable from the growth of other revenues.

Table 5: Profit data of Ali Group from 2108 to 2020

Source: Ali's annual reports

Data from Ali's Consolidated Financial Statements				
	Year ended March 31,			
	2018	2019	2020	
(in millions of RMB)				
Revenue about China commerce retail:				
– Customer management	114,285	145,684	175,396	
– Commission	46,525	61,847	71,086	
– Others	15,749	40,084	86,268	
Total	176,559	247,615	332,750	
Net income attributable to ordinary shareholders:	63,985	87,600	149,263	
Earnings per share attributable to ordinary shareholders:	3.13	4.24	7.10	

The increase in shareholders' wealth could be seen more clearly from the data of annual reports shown in Table 5. Even though, for FY18 ended 31 March 19, the Group's other income, total China retail commercial income, net income attributable to common shareholders and earnings per common share increased as compared to FY17; those measures climbed even more in FY19, about twice as much as in FY18, especially as other income more than tripled. And the increase in these data means that both the profitability of the company and the wealth of the shareholders have increased after the acquisition. Admittedly, the benefits are related to the Kaola's performance contribution.

6. Conclusions

This paper aims to analyze the motivation of the acquisition of Alibaba group and Kaola.com, the method of paying consideration in the acquisition, and the impact of this acquisition on the acquirer and the acquiree. Through the case study, the following conclusions could be drawn. First of all, for the acquirer, Ali, through the acquisition of Kaola, it has made up for its business shortcomings, expanded the overseas market, and increased the business model of membership. At the same time, Ali has reduced its exposure to unsystematic risk by increasing its portfolio of Kaola. Secondly, for NetEase, the parent company of the acquiree, the profitability of the whole company has been improved by removing Kaola, the departments with weak profitability, and maintained the revenue growth rate required by investors. Finally, for the acquirer, Kaola, its immature supply chain technology has been bolstered and it has fended off hostile takeover by the competitor. According to the research, for the company, friendly acquisition could form complementary advantages in business in the short term, and could improve the company's profitability and increase the accumulation of shareholder wealth in the long term.

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