Internet 2026 outlook: The start of a new expansion cycle (summary)

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Returning to an expansion cycle. Under pressure from the macroeconomic environment and valuation contraction in the capital market, the internet sector has undergone about three years of contraction amid companies' efforts to reduce costs and improve efficiency. However, the financial conditions of companies in the sector have generally improved. In this context, most internet companies are seeking to explore new growth drivers and opportunities. Faced with emerging industry-wide opportunities, internet companies are investing in AI, overseas expansion, and instant retail, and we believe the internet industry is returning to an expansion cycle.

We suggest distinguishing between specific expansion behaviors of internet companies. We do not believe investors in the market will invest in internet companies simply because they are expanding; instead, firms will make investment decisions based on changes in companies' earnings and businesses resulting from the outcomes of their different strategies.

First, we are cautious about internet companies' expansion strategies that focus on the domestic consumer market as we believe the macroeconomic environment and online penetration rates for various industries are insufficient for supporting substantial incremental growth potential for these companies. In most cases, we believe such strategies could negatively impact internet companies.

Second, we are relatively optimistic about internet companies' expansion strategies that focus on overseas markets, which we think could eliminate the ceiling on their growth in the domestic consumer market. However, we suggest paying attention to whether these

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companies are expanding their presence in overseas markets through virtual products, physical goods, or services.

We believe the challenges for internet companies in expanding their overseas presence through virtual products stem from cultural differences between domestic and international markets. Additionally, the difficulty in expanding through physical goods lies in whether platforms can recognize the high-risk, high-return characteristics of cross-border trade. We also believe that the challenge in expanding overseas through services is that reusable resources for these companies are relatively limited in overseas markets.

Third, we are most optimistic about internet companies' AI- and technology-related expansion, which we believe is largely independent of the ceiling on their growth in the domestic consumer market. Compared to the substantial investments in AI made by overseas tech giants, we think that investments by domestic internet companies, even the most aggressive in exploring AI, still have considerable room for growth. As we see bottom-up innovation driven by AI as a clear trend, we believe that the incremental demand generated by AI models, computing power, and applications will present new opportunities for internet companies.

From the perspective of the capital market, we believe AI could also drive re-ratings for companies. During 2023–2024 when the performance of the internet sector was relatively weak, diverse valuation methods for the sector became ineffective and the EPS-based valuation method emerged as a major approach for valuing companies. In this context, existing businesses that cannot contribute to internet companies' EPS have been selectively overlooked or even assigned negative valuations by investors in the market, regardless of their growth prospects or competitiveness.

Since the start of 2025, the AI boom driven by DeepSeek has led investors to separately value Alibaba's cloud computing business and has prompted re-ratings for Meitu's and Kuaishou's AI apps (e.g., Kling). We believe that re-ratings driven by AI will continue to emerge and evolve in the internet sector.

Risks: Disappointing performance of the economy; deterioration in China-US relations; disruptive innovations brought by new technologies.

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Online transaction platforms: Investing in overseas expansion, instant retail, and AI

Online transaction platforms: Broader market resilient; performance of different product categories and companies may diverge.

E-commerce platforms: Thanks to the boost from government subsidies and instant retail, the overall performance of the e-commerce market has been relatively resilient in 2025. We think that the YoY growth of the online e-commerce market's gross merchandise value (GMV) will slow in 2026, and that sales of product categories such as consumer electronics and home appliances may face pressure from a high base after the effect of government subsidies fades.

Local life service platforms: Competition in the food delivery service market has accelerated market expansion. Using per capita household spending on food, tobacco, and alcohol as the denominator, we calculate that the penetration rate of food delivery services was about 16% in 2Q25, up from 14% in 2Q24.

Competitive landscape: E-commerce platforms are shifting the focus of their competition. Amid "anti-involution" policy efforts, major platforms are no longer prioritizing low prices but are exploring new directions of businesses that suit them. Alibaba and JD.com are focusing on the instant retail business, PDD is focusing on exploring overseas markets, and Douyin is emphasizing AI.

As for local life service platforms, fierce competition in the food delivery service market led to significant losses in 3Q25, and we suggest paying attention to how the competition will unfold. E-commerce platforms began increasing investment in food delivery and instant retail businesses in 2Q25. However, we have not seen financial or operational indicators demonstrating that e-commerce platforms' investment in the food delivery business could generate sufficient synergies, and we suggest monitoring this situation.

Potential catalysts and growth drivers ahead. First, we expect new growth momentum from overseas markets. Given the significant impacts of tariffs in 2025, we think e-commerce platforms exploring overseas markets will accelerate the transformation of business models, expand their presence in various regions of the world, and strengthen local operations. Food delivery service platforms' efforts to explore overseas markets are still at an early stage. For example, Keeta is striving to explore the Middle East and Brazil markets.

Second, we think the instant retail business may become a new growth driver for e-commerce platforms, but it is likely to contribute more to platforms' incremental business volumes than their incremental profits. We believe that the instant retail business will generate incremental business volumes for traditional e-commerce platforms through cross-selling and will increase the penetration rate for online sales of product categories such as everyday necessities and fresh food. However, given the fulfilment costs associated with the instant retail business, we think it is unlikely to make a significant contribution to e-commerce platforms' incremental profits in the early stage.

Outlook for OTA: Domestic and outbound travel markets resuming reasonable growth; overseas markets to contribute incremental growth

Domestic and outbound travel markets resuming reasonable growth. In the domestic market, the number of travelers recorded single-digit YoY growth during several holidays in 2025, indicating consumers' solid willingness to travel. We expect the performance of the domestic travel market to remain strong in 2026, with pressure on hotel and air ticket prices easing. In the outbound travel market, the number of outbound flights has exceeded 85% of the pre-pandemic level since the beginning of 2025 and recovered notably during the peak demand season in the travel market, showing significant YoY growth. Since June, competition from JD.com, Fliggy, and Umetrip has affected the online travel agency (OTA) market. However, traditional OTA platforms' core competitive strengths in supply chains, user habits, and customer services have remained intact.

Overseas markets to drive growth; inbound travel business to benefit from favorable policies. This year, Trip.com Group's "Trip.com" brand has demonstrated that exploring the Hong Kong SAR and Singapore markets is a feasible strategy, gaining considerable market share and generating profits in these markets. Meanwhile, Trip.com Group has accelerated customer acquisition and business expansion in Asia-Pacific countries (e.g., Japan and South Korea) and the Middle East region. Even if Booking's Agoda increased subsidies for the Asia-Pacific market, this has not substantially affected the growth of Trip.com Group's hotel-related business.

Moreover, amid China's efforts to further optimize its visa-free policies for inbound travelers, differentiated strategies for the inbound travel business have created customer acquisition opportunities and improved brand awareness for platforms such as Trip.com. We remain optimistic about OTA platform companies including Trip.com Group.

Outlook for cloud computing: AI to be a key variable that may cause large tech firms' valuations to diverge

Strong demand for AI in the domestic market; companies stepping up efforts to expand their overseas presence. Demand for AI remains robust in the domestic market. Since its launch in 2025, DeepSeek has quickly gained popularity and generated enthusiasm for exploring large-language model (LLM) applications across various industries. Breakthroughs in LLM technologies and ongoing efforts to optimize the cost-effectiveness of LLMs are facilitating large-scale use of LLMs in multiple sectors.

In this process, we believe cloud companies will be among the first to benefit. LLM training, inference, and application deployment rely heavily on support from cloud GPU services. Meanwhile, Chinese cloud companies play an important role in the R&D of industry-leading LLMs. We note that demand for AI is particularly strong in sectors such as internet, games, mobile phones, automobiles, financial services, and government sectors.

Building knowledge databases for enterprises, upgrading intelligent customer services, intelligent code generation, and optimization of data training have become key areas for AI technology application. We believe this will directly drive the growth of cloud GPU services and boost demand for public cloud services in sectors such as traditional computing and storage. In addition, we note that Chinese cloud companies are striving to expand their presence in the global market by enhancing infrastructure capacity and developing key technologies.

Raising capex to invest heavily in AI; striving to explore domestically produced chips. Since early 2025, some Chinese cloud companies have anticipated high capex for AI. For example, Alibaba announced plans for AI infrastructure construction earlier this year and expects to spend Rmb380bn on that construction over three years. At a conference in September, 2025[1], the firm announced that it would continue to increase investment in AI infrastructure and it expects the scale of Alibaba Cloud's global data center energy consumption in 2032 to be 10 times that in 2022. In some key segments of the AI computing power market, the use of domestically produced chips has become an industry trend.

Upgrades of AI models, changes in AI demand, expectations for AI investment, and efforts to build AI ecosystems are clear themes in China's AI industry in 2025. We believe these themes will remain the focus of market attention in 2026 and may become key variables that cause valuations of

[1] https://mp.weixin.qq.com/s/YWv9gYvmbPGj_g67iTJFUw [text in Chinese]

leading tech firms to diverge, playing a key role in investors' analysis of related companies' long-term value.

Online platform sector: AI to drive important changes in the sector

AI to improve the efficiency of existing businesses. We believe AI-driven upgrades of algorithms and interaction methods will reshape search engines and may usher in an era of AI-powered search. For example, the total search volume of Google increased YoY after the launch of its AI Overviews.

In the advertising platform sector, we think the integration of generative AI into recommendation algorithms could enhance the content of advertisements and may benefit leading platforms (especially No.2 and No.3 platforms) in the sector, as LLMs' in-depth analysis of data could help advertising platforms better understand user interests based on a relatively small amount of data. In the overseas market, Meta has made rapid progress in improving advertising efficiency based on AI-driven algorithm upgrades. In the domestic market, we believe major advertising platforms such as Tencent and Kuaishou could also benefit from the efficiency improvements brought by AI-powered recommendation algorithms.

New AI applications to present opportunities. Based on MIT's report [The GenAI Divide: State Of AI in Business 2025], the media industry is likely to be one of the most affected by AI. AI-powered productivity tools are reshaping content production. Google's Veo and Kuaishou's Kling are currently first-tier AI-powered video generation tools, while Meitu focuses on AI-powered productivity tools for image processing. In the early stages of development, we expect rapid business expansion, rather than competition between existing companies, in related industries. Meanwhile, we think that competition between LLM-driven business models (e.g., Nano Banana) and specialized app business models (e.g., Meitu) may continue, with factors such as potential market size, customers' reliance on products, and the degree of customization will determine the growth potential of related app products.

Ecosystem to be a crucial factor for competition over AI agents in the long term. Based on current consensus, AI agents are likely to represent the ultimate form of product for AI applications. AI agents function more as AI-powered "assistants" for users, and we believe such products enjoy high customer loyalty and considerable growth potential. We consider factors such as AI models, data, and commercialization ecosystems to be crucial to competition over AI agents. From the perspective of commercialization ecosystems, we anticipate that performance-based advertising based on business models similar to the "cost per sale" business model may become a major monetization method for business-to-consumer AI agent products.

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