Company Name: JD.com
Company Ticker: JD US
Date: 2017-05-08
Event Description: Q1 2017 Earnings Call

Market Cap: 52,724.99
Current PX: 36.76
YTD Change($): -4.66
YTD Change(%): -11.251

Bloomberg Estimates - EPS
Current Quarter: 0.939
Current Year: 4.382
Bloomberg Estimates - Sales
Current Quarter: 98851.389
Current Year: 469159.257

Q1 2017 Earnings Call

Company Participants

- Ruiyu Li
- Sidney Huang
- Richard Qiangdong Liu

Other Participants

- Eddie Leung
- Alicia Yap
- Alex Yao
- Alan Hellawell
- Evan Zhou
- Grace Chen
- Jin-Kyu Yoon
- Ronald Keung
- Natalie Wu
- John Choi
- Eric Wen
- Jia Long Shi
- Tian X. Hou
- Ming Xu

MANAGEMENT DISCUSSION SECTION

Ruiyu Li

GAAP and Non-GAAP Financial Measures

Also, this call includes discussions of certain non-GAAP financial measures

Please refer to our earnings release which contains a reconciliation of non-GAAP measures to the most direct comparable GAAP measures

Sidney Huang

Financial Highlights

Revenue Growth

- We are very pleased to report a milestone quarter with not only solid revenue growth, but also record GAAP and non-GAAP profitability
- Our net revenue grew 41.2% in Q1 2017, supported by better than expected growth momentum across all of our key categories

Direct Sales, Services and Others

- Our direct sales revenues grew nearly 40% in Q1 led by food and beverage, cosmetics, home appliance and baby products
- Our revenues from services and others increased 62% y-over-y, supported by higher advertising revenue as well as income from financial services

JD Finance

- Excluding the impact from JD Finance, assuming the spin-off had taken place, our net revenue would have grown 39.8% on a y-over-y basis
- We disclosed this pro forma revenue growth rate in earnings release, as it is relevant to our investors as we anticipate the completion of the JD Finance reorganization
- If the spin-off is completed in Q2, we will begin to deconsolidate the JD Finance financial results in Q2 and move it into a single line item called income or loss from discontinued operations on our income statement
- In that case, JD Finance revenues would no longer be included in our consolidated revenues, while certain marketing services provided by JD.com to JD Finance would be recognized as part of our consolidated service revenues
  - Therefore, investors should use the pro forma revenue growth when modeling your 2017 growth projections

GMV

- Our GMV grew 42% y-over-y in Q1, as we continue to focus on the quality rather than quantity of our marketplace operations
- GMV from general merchandise categories grew 48% during the quarter
- Food and beverage, home furnishing, cosmetics, and baby products were the fastest growing general merchandise categories, while our top brands from apparel and footwear categories grew over 70% as we improve traffic towards high-quality merchants
- GMV from electronics and home appliance products grew 37% during the quarter, led by the home appliance category

Gross Profit and Margins

- Gross profit increased 58% in Q1, which continued to reflect the healthy monetization of both our 1P and 3P businesses
- Gross margin for our direct sales revenue improved over 100BPS from a year ago, as a result of increased economies of scale across all key categories which was the biggest catalyst of the gross margin expansion
- JD Finance was the second largest contributor to the improved gross margins followed by our advertising business
- However, the JD Finance gross margin was somewhat overstated because part of the interest cost was due to the JD parent company, which is eliminated in our consolidated financial results

    - Excluding JD Finance, our gross margin would be lowered by 68BPS in Q1

Fulfillment Expense Ratio

- Non-GAAP fulfillment expense ratio was 7.5% in Q1 compared to 8.2% in the same quarter last year
- The lower fulfillment expense ratio was attributable to the operating leverage in our nationwide installed base in the logistics infrastructure, the improved average ticket size in our first-party business in Q1, and the higher base last year before merging JD Daojia into Dada

Operating Margin and Income

- The non-GAAP operating margin improved to 2.2% in Q1 compared to non-GAAP operating loss in the same quarter last year
- Of the 270 basis point margin improvement, roughly 160BPS are attributable to JD Mall margin improvement, while the remaining from reduced losses of JD Finance and impact of the Dada merger was JD Daojia
- Our GAAP operating margin also had a 270 basis point improvement on a y-over-y basis and has turned positive to 1.1%
- The difference between our GAAP and the non-GAAP operating income was RMB 823mm or 1.1% of our net revenues

Net Income, EBITDA, FCF and CapEx

- Our non-GAAP net income attributable to ordinary shareholders also reached a new record of RMB 1.5B, with a net margin of 1.9% in Q1
- And our GAAP net income was RMB 239mm with a net margin improvement of 200BPS
- The non-GAAP EBITDA reached RMB 2.2B with an EBITDA margin of 2.9%
- Our FCF remained strong
- For the trailing 12-month ended March 31, 2017, FCF totaled RMB 16.8B, up 120% from the previous trailing 12-month
- However, as previously emphasized, there is a delay in our logistic-related CapEx plan due to the lengthy process of acquiring land in China
- We expect our CapEx to significantly increase; and as a result, our FCF will likely decline in the remainder of 2017

JD Finance Reorganization

- Before I discuss our financial outlook, let me give you a quick update on the JD Finance reorganization
- Based on the current progress, we expect the deal to likely close within Q2
- So our Q2 results from continued operations would likely exclude JD Finance
- As mentioned the last time, we expect to receive RMB 14.3B in cash as part of the transaction
    - While the gain from this transaction will be booked directly in the equity section without any P&L impact, it is a real financial gain to our shareholders

Outlook

Net Revenue Growth

- Now, let's discuss our financial outlook
- We expect Q2 net revenue growth to be between 35% and 39% on a y-over-y basis
- Excluding JD Finance, the revenue growth would be expected to be between 33% and 37%
- This guidance reflects our solid growth momentum from a seasonally strong quarter last year

Profitability

- Finally, I would like to say a few words on our profitability
- We are obviously pleased with the healthy profit achieved in Q1
- However, we would like to caution our investors that Q1 results are not necessarily an indication of our long-range earnings in the remainder of 2017
  - First, we have various new business initiatives in our aggressive expansion plan, which will drive long-term growth and shareholder value
  - Second, the Chinese e-commerce market remains highly competitive and we remain committed to returning a meaningful portion of our incremental gain from the scale economies back to our customers
- Therefore, our quarterly earnings will likely be lower in one or more of the next few quarters
- Nevertheless, our Q1 profitability does confirm and reinforce our conviction that our business model is stronger than ever and our unwavering focus on superior customer experience will pay off for our long-term shareholders

QUESTION AND ANSWER SECTION

<Q - Eddie Leung>: I would like to have two very quick questions. The first one is, we noticed that the GMV per fulfilled orders is kind of like going up year-on-year. So just wondering, while the ticket size can – improved in this quarter, is it more a mix shift kind of thing? Any color would be helpful.

And then secondly, Sidney, you mentioned that we need to be a bit cautious on the upcoming quarterly earnings for the rest of the year. So just wondering if you could give us a bit more color on what cost items might increase relatively to Q1 in a bigger magnitude? Thanks.

<A - Sidney Huang>: Okay. So on the ticket size, we did notice a y-over-y improvement actually since Q4 last year. Partly it's because our electronics categories are also growing at a very fast pace. So the previous mix shift towards general merchandise – at least the impact is becoming smaller.

Secondly, our general merchandise categories, namely FMCG products, we do see ticket size improving meaningfully as well. This is definitely driving at least in part to our improving fulfillment expense ratio.

As we mentioned in the past, the objective for us to invest in FMCG and our conviction in this category is partly dependent on our ability to drive the ticket size up, as consumers form their habit of buying groceries online. So the recent trend is definitely very, very encouraging, as we see consumers buying more and more in each order.

So, we do see the improving ticket size across all categories. So despite of the mix continue to shift towards general merchandise categories, our overall first-party ticket size on average has also been improving over the last few quarters.

On the cautionary note on P&L, I think it's really more of a general note. I think we do have a very, very good first quarter. But keep in mind, first quarter has generally less promotional activities. Second quarter, for example, when we invest in our annual sales event on June 18, we will return a lot of value back to our consumers.

So as I mentioned earlier, there are also a number of new strategic initiatives that we have planned for this year, and some of them have not started or only starting. So, the full cost of those initiatives have not been reflected in our first quarter results. But I think this is more of a general note rather than a very specific forecast for the next few quarters.

<Q - Alicia Yap>: My question is actually related to your disclosed new business line, excluding JD Finance on that revenue line. It seems like this quarter there is about RMB 900mm also in this line.

Is that mainly related to your revenues from your Indonesia subsidiary? And can you remind us, is this Indonesia subsidiary mainly is a 1P business? And also kind of related to that. What is management view on the potential for Indonesia market going forward and overall plans and strategy there? And then any comment on the recent reported news about JD potential investment into Tokopedia. Thank you.

<A - Sidney Huang>: Sure. So yes, you noted this detail. It is really the remaining new businesses outside of JD Finance. It includes our overseas businesses, including Indonesia and also some other new business initiatives. So we didn't break out in details, but the Indonesia operation is part of that. We are actively looking at various opportunities in the Southeast Asia region, but we don't comment on any market rumors, any particular transactions.

<A - Richard Qiangdong Liu>: So, let me elaborate a bit on our Southeast Asia strategy. For Indonesia, we expect for the next five years, we will be focusing on building out the basic infrastructure, including warehouses and the last-mile delivery network. So in those five years, we are not really focused on building up the GMV or number of orders. The key is to build a very solid infrastructure both logistically and on a fulfillment and procurement – everything very, very, crucial to build a superior customer experience. So, if we can replicate our super customer experience in China, I'm sure we will achieve similar success in Indonesia.

<Q - Alex Yao>: I have a question on 1P margin. If my math is correct, 1P margin improved by 80BPS this quarter. To what degree is this margin improvement driven by category mix change, and to what degree is it driven by same-category margin expansion? And then, how sustainable is this 80 basis point margin improvement on y-over-y for the rest of 2017? Thank you.

<A - Sidney Huang>: Right. I mentioned earlier actually our first-party margin – gross margin improved over 100BPS and we have seen over 100 basis point improvement at least for the last four quarters, if I remember correctly. So, this is definitely a quite sustainable and consistent improvement.

Now, maybe after the four quarters, we'll reach at some sort of anniversary, so I cannot guarantee you on a forward basis. But as I mentioned, because we are still building out our scale and number of categories are still not – we are not the biggest in the country. And even with the categories that we are already the market leader, we can continue to improve our gross margin by working with our partners to come up with special promotion programs or exclusive launch of new products, for example. These are all creative approach and opportunities to continue to improve our gross margin.

As Richard actually commented a few quarters ago, when we reach a market leadership position, not only we can grow our margin because of scale economies, but we can also grow even stronger on the volume. So I think in the last two, three quarters, after his comment, we actually saw great validation on that point. So again, the growth came from across the categories and the margin improvement also came from all the key categories.

<Q - Alan Hellawell>: In FMCG, where has subsidy intensity trended as a percentage of GMV, and where might we expect it to go for the balance of the year?

And could you also give us an updated sense of what we should assume the New Dada equity loss pickup should be for 2017? And finally, what percent of 1P GMV might now be apparel, and what is our longer-term target? Thank you.

<A - Sidney Huang>: So on FMCG, it's actually one of those categories we are still a few spots away from number one. So as I mentioned again earlier, when we grow in a very meaningful way, we see tremendous incremental rebates from our suppliers. So, we don't have to cut back on our promotions, we don't have to sacrifice our everyday low price, but our margin will improve naturally as we grow our scale.

We have also implemented some policies to encourage consumers buying bigger basket, which also improved the overall economics of the FMCG category. So it is still burning money – burning very significant money, and we are committed to continue to invest in this category. And nevertheless, that the profitability from our other categories will be more than sufficient to support us to combat whatever the battle is required to win this category.

On the Dada pickup, as I mentioned earlier, it's – and obviously, we don't control the business, we don't try to influence its operations. Management has full discretion on carrying out its own strategy. But just for your own purpose of modeling, you could assume roughly RMB 100mm on a non-GAAP loss on a monthly basis, which has not changed for the last few quarters when I guide this.

And for the first-party, GMV from apparel, I can tell you it's growing very, very fast, but it's off of a very small base. But we are very optimistic about this category, because – in fact, senior management including Richard is personally visiting many of the top branch around the world and we have seen great, great interest from these top brands eager to work with JD.com, as we present probably the most credible and most quality-focused platform in China for e-commerce.

<Q - Evan Zhou>: My question is regarding our operating expense leverages. Holding specifically on fulfillment, I think we've seen pretty disciplined extraction of leverages for this quarter. And I was wondering can we kind of assume this to continue or any further investments into, like Sidney mentioned, the CapEx may have some impact on to these cost items down the road.

And also on technology and content. I think Richard has been pretty vocal about we're going to invest pretty actively in technology in the following years. This quarter also seems to be pretty – I think your comp seems to be pretty high. So, I was wondering like regarding your comment on further investment initiatives especially on the technology side, what should we kind of expect major items and how should we kind of quantify the impact on this line down the road? Thank you.

<A - Sidney Huang>: Okay. So first on the fulfillment. So, it depends – the trend will depend on our ability to continue to drive efficiency. So, we have build out our nationwide logistic infrastructure over the past three, four years to the lower-tier cities. In that process, we have invested basically in low order density areas. But once we have the installed base, as we grow our volume, the average efficiency ratio or – for example, for delivery average orders per delivery man will naturally improve. So that's one driver for additional fulfillment efficiency.

And then two is, as I mentioned, on ticket size. So, there are various ways to encourage consumers to buy more. So those will be the two key drivers for further fulfillment leverage. Having said that, we are also investing in this area. For example, cold chain is one of the major areas for us to invest aggressively this year, which will be a slight negative to the fulfillment expense ratio.

On the R&D, the key investment will be talent. So, this is actually one of the areas that I mentioned earlier that we are starting, but it's far from finishing. So we will continue to hire many, many more senior talents from around the world in areas that are critical for our long-term growth. So we are expanding our Silicon Valley office, for example. We are also hiring senior talent from other parts of the world. So on that part, you will probably see even higher growth in the R&D expense line.

<Q - Grace Chen>: My question is about your margin trend. Can you share with us your non-GAAP operating margin in the mid- to long-term? I can understand that there will be quarterly fluctuations over time due to seasonality or investments in the future, but I'm wondering what would be your margin target in the mid- to long-term.

For example, in the next two to three years, what will be the key drivers to achieve your margin target? For example, like 1P margin expansion [indiscernible] scale or [indiscernible] exchange or like 3P take rate increase pay you – help us run these drivers in terms of impact? And also, if you can walk us through your thoughts about the logistics spending required in order to support the scale and margin target, that'd be great. Thank you.

<A - Sidney Huang>: Yeah. So on the margin trend, I think we don't comment on the short term, but I think medium-to-long term, we have spoken in the past. If you look at our first-party business, we would like to compare our current gross margin for the direct sales business vs. the top offline retailers. Our gross margin today is still lagging behind, on average, roughly 10-plus percent. And this presents great, great opportunities for us to continue to improve the gross margin, not at expense of customers, but really from continued scale economies, volume-based rebates, and also creative joint programs helping our top partners. So this is on the gross margin.

And then, on expense line, you probably saw our investors slide where we compare our JD Mall expense ratio with the top offline retailers in China. We still enjoy a 5 to 6 percentage point advantage on overall expense ratio. And this is really the key drivers for our long-term profitability, because we can operate more efficiently than our key competitors, so we can afford to offer everyday low price to our consumers while we can still earn a decent profit.

So coupling with those two metrics, you can comfortably project our first-party net margin should be at least similar to the best offline retailers which traditionally ranging from, I guess, 3% to 5%. And if you consider the more competitive environment, you take a haircut you'll still get 2% to 4%. And then on top of that, you will have the marketplace business which has good benchmark in China and in the U.S.

If you take the net margin of GMV, you get somewhere around 1% to 2% as the net earnings, and you can translate that into a margin based on revenue. So you add those two together, you can come up with the long-term margin target for our business. And that's before we consider any other new business line.

<A - Richard Qiangdong Liu>: Yeah. So in the long-term, our net profit margin will clearly be higher than any of the offline retail players.

<Q - Jin-Kyu Yoon>: In recent past, I think you guys mentioned that GMV and revenue GAAP – growth GAAP should close which it has. But with incremental contributions from FMCG and groceries and coupled with low base on a 3P side from last year, should we expect the GMV side of the equation to grow meaningfully faster than revenues going forward? And perhaps you could give us some color on this relationship in the near term as well as the long term? Thanks.

<A - Sidney Huang>: Yeah. So I think the near-term GMV growth rate slowed down because we have been focusing more on the quality rather than quantity of the number. So this has been consistent over the past three, four quarters. We do foresee this will still continue to some extent, given that a lot of the activities – again, as we mentioned earlier, there is a little bit – you develop your system to catch some of the production activities, but because it has become a sophisticated industry, the production regions will continue to come up with new tactics.

So we want to maintain the integrity of our platform, so we'll keep new technologies to continue to crack down. Having said that, you should expect GMV in a medium- to long-term – on a medium- to long-term basis, growing faster than our revenue given the long-tail categories do present a better opportunity for longer-term growth.

<Q - Ronald Keung>: Just want to ask a bit on your offline/online initiatives. And we heard about the grand scheme for the 1mm convenience stores over five years. Any updates on the – in term of unit? We also read about the 5,000 maternity stores and the 10,000 home appliance stores. Different periods and different targets mostly under this franchise model, but we'd love to hear any updates on each of these three initiatives and some of the mid- and long-term target for these in contributing to revenue and profits? Thank you.

<A - Richard Qiangdong Liu>: Yeah. So, we actually started from last year various initiatives to focus on a bridge between online and offline. Yeah. So in addition to what you have seen such as 1mm convenience stores and over 2,000 JD Bang home appliance service centers and also hundreds of JD home Jingdong Daojia new stores. We are also working on some other new initiatives that have not been publicly announced.

So first of all, all of these offline initiatives, they are on a franchise model. So they are not asset-heavy, it's actually a relative asset-like model. So, there are several characteristics for these initiatives. One is, they tend to be in the highly-dense population areas or they are in areas where it's difficult to reach via e-commerce, such as rural areas.

So, we will enable these franchisees in several fronts including our plant, our supply chain, our procurement and also our logistic capabilities. So we believe, through these various O2O initiatives, we can bring to different groups of consumers on different types of categories very unique value proposition in addition to our online e-commerce business.

And lastly, for all of these models, from day one we adapt a philosophy not to – unlike to our e-commerce model that we burned quite a bit of money in the beginning, we do expect all of these models to be profitable since day one.

<Q - Natalie Wu>: My question is regarding fulfillment. Can you give us an update about how much percentage of your pop orders is fulfilled by JD? And how much marketplace merchants adopt JD's warehouse this quarter?

So, last quarter you've mentioned that the ratio has been increased from low single-digit to high single-digit, but you also said that it was related to the seasonality, additional promotions, so still remains to be seen. So just want to get some kind of feeling about the recent update?

And since JD fulfillment is now established as the new business group, so we're just wondering will the new group – should we anticipate any kind of innovation or aggressive expansion regarding this new business group going forward? Thank you.

<A - Sidney Huang>: Sure. Yeah. So in Q1, we continued to fulfill on the delivery side low-20s in terms of number of orders on the platform – on the marketplace fulfilled by JD. And for warehousing and delivery integrated services, we are quite pleased that after Q4 we saw the volumes stayed up pretty high, continued to be in high single-digit in Q1. And the recent announcement, which is – mainly for domestic purpose to have JD Logistics as a separate business group.

The purpose of that is to empower the group to be able to operate on a more autonomous basis with more decision power, and also – so that they can serve – leverage their capabilities spilled over the years to serve the third-party business partners. And you mentioned about whether there will be more innovation? Innovation has always been one of the key advantages for this group. So definitely, they will continue to build upon those innovative spirit. And now they can – even more dedicated to serving the outside business partners. So, it is – we do expect this new restructuring will support. It's subjective to better serve the outside parties.

<A - Richard Qiangdong Liu>: Yeah. So on the logistic opportunities, I would like to add a few words. So we have seen in the recent years that there's tremendous opportunity for logistic services. In the past, we have seen brands mainly relying on self-build logistic capabilities. But now, increasingly, we see brands outsource these logistic functions to more capable third-party service providers.

Yeah. So for JD Logistics, through intensive investments over the past 10 years, we have built a lot of capabilities including the large appliance products for both warehousing, installment and delivery services. And the mid- to small-size parcels, we have a very fully integrated network. By the end of this year, we expect to cover actually all counties and districts across China.

For our cold chain logistics, we are also forming a decent base for further enhancement. Yeah, we have covered over 100 cities. We also have the unique system of crowdsourcing delivery network powered by Dada. We also have quite a few founded warehouses serving cross-border logistic purposes. And over the years, we have supported purchases by large businesses and also our initiative in the convenience store services. So we have now also built a network to serve the businesses.

So, JD Logistics is probably the only logistic player in China today that have the capability of – basically six logistic networks, have the capability simultaneously across all six. Yeah, this benefit from JD.com already have these various use cases through e-commerce. So we have the privilege of building out those capabilities along the way.

And so, our objective of forming this new business group is to leverage these capabilities to fully open to our business partners across the country, so that others can benefit from these capabilities as well. But I firmly believe that JD

Logistics will transform from a cost center to a profit center over the next few years, so that it can create shareholder value for our long-term shareholders.

<Q - John Choi>: I have a question on your third-party online marketplace. It's been about a year since we see the – you guys have been taking more aggressive stance on the production activities. Could the management share with us about the recent trends and what kind of trends that you guys are seeing? Should we expect more merchants this year as compared to last year in a more aggressive pace?

And also a quick follow-on on the cold chain investment. Just wondering how much investment are we talking about here? I think Richard has mentioned that more than 100 cities covered at the moment. How much has been spent and what level of coverage are we talking about? Is it going to be similar to the last mile?

<A - Sidney Huang>: Yeah. For the 3P marketplace, the emphasis has been on quality over quantity as I mentioned earlier. So if you look at – what we track is the growth rate of our top 20 merchants. And you can see that their growth rate has been very, very healthy. And not that we're only focused on the big merchants and I said – quality merchants, so they could be very large, could be very small. But as long as they are high-quality merchants, we will really invest our resources and traffic towards those quality merchants.

So the trend, it will continue – I guess, the best trend will probably be customer experience. So we are closely watching consumer feedback. We actually saw from some third-party survey that consumers are actually appreciating the improved merchant quality. So, that's probably the most important measure for us at this point.

So in terms of the number of merchants we'll release as of April 30 the number of merchants is similar to the year-end merchants because we just go through the contract resigning or renewing process. So, we again replaced some poor-performing merchants with better ones.

On the cold chain, it's a meaningful investment. But given our very, very large scale today, it's actually not something we'll require separate disclosure. It will be absorbed in our total fulfillment expenses, you probably won't feel. In fact as you see that, our fulfillment expense ratio actually improved despite of the investment in cold chain. So the investment will continue, but no worries, it's going to be stand out in terms of hurting the profitability.

<Q - Eric Wen>: I have some questions regarding your logistics business. By logistics, I guess, it means goods handled outside of our direct and pop businesses. First, how do we account for the GMV and the logistics? And what is the GMV contribution this quarter and what growth do we expect in say three years? What kind of take rate can we expect for the logistics business, and what kind of gross margin should we model for this business.

And lastly, how do we plan to allocate warehouse, transport and delivery resources between our own business, pop, and logistics business in terms of CapExs? Thanks.

<A - Richard Qiangdong Liu>: Yeah. The reason we called JD Logistics instead of JD Delivery is that, we wanted to provide integrated warehouse and delivery services. Yeah. We believe only the integrated warehouse and delivery services will provide superior customer experience. Yeah. So because we just started to reorganize within the group, so we don't have separate P&L yet. But I can assure you that once it started to operate on the new structure, it should be profitable from day one.

Yeah. The key measure for this unit's success is the percentage of revenue from third-party sources. Yeah. Only when the majority of the revenues and profit are coming from third-party sources then it will be measured as – it will be deemed as success.

<A - Sidney Huang>: So just quickly on the one point – when you talk about GMV, there's really no GMV or very limited GMV involved in the logistic services. It will have some revenues, but not GMV. Keep in mind, this general merchandise volume. So, logistics does not have any GMV.

<Q - Jia Long Shi>: I have a follow up on the previous logistic question. I just wonder, as of Q1 what is the percentage of the JD Logistics revenue from third-party merchants? And also for your 3P business, it's also a follow up on previous question. It seems Q2 last year was low base for your 3P business due to the anti-brushing campaign. So is it reasonable to forecast an accelerating GMV growth for your 3P business starting from Q2 this year? And also, what is the 3P GMV growth in Q1, if we exclude the virtual goods items? Thank you.

<A - Sidney Huang>: Okay. Yeah. So for logistics revenue, today it's very small, given it's a fairly new business. So we've said in the past, you can just take 1% as a rough number for now. It's not going to change significantly in the near term. And for the third-party marketplace, as I mentioned earlier, it is ongoing effort to continue to improve the quality. But on the other hand, we do hope that the better quality merchants will see accelerating growth. In fact, we have seen the better quality merchants growing on an accelerated basis. I cannot assure you or I cannot guide – we don't guide GMV on a going forward basis, but I can tell you the underlying trend has been very healthy.

<Q - Tian X. Hou>: I have a question regarding the user side. So as your active user annually already reaching 236.5mm. I wonder what do you see about the potential of your active user on the platform? And what's the strategy going forward in terms of user acquisitions? And related to that, how do you see the user acquisition costs, the trends of that. That's my question in the user front. Thank you.

<A - Sidney Huang>: Yeah. So I think for – given there is a competitor in the market with a larger user base. So, I think we have fairly good low-hanging fruit in terms of user acquisition because these are already e-commerce users. So our effort, for example, expanding into the lower-tier cities is to reach out to these consumers even though many of them today may not be the ideal customers, given that the income level maybe slightly below our typical customer profile. But we have seen many of them started trying JD.com, sometimes could be just for one transaction. But we are increasing our visibly in the lower-tier cities.

So, we do see tremendous potential for user growth and there is no limit really. And as far as acquisition cost, it's quite – it's very tough to actually pinpoint a user acquisition cost because it's resulted from a combination of marketing activities, branding, and promotions. But you can see that our marketing expense ratio actually this quarter has slightly declined. So, we will continue to invest. And particularly this year, given the improving profitability, we are actually or probably going to spend more on branding. So sometimes, this branding cost may not see immediate GMV benefit, but we're sure that it will yield long-term benefit to our platform.

<Q - Ming Xu>: So my question is also related to the offline investments. So Richard, you mentioned you have various plans, precisely 1mm supermarket for your O2O initiative. So my question is specifically on the fresh good grocery market in Tier 1 cities. So, do you have any specific plan beside the Dada business?

And also, we noticed your competitor and also some venture capital backed startups are very active in this field and they tend to operate a 1P business model, while you mentioned you tend to do a kind of franchise business model. So how do you – so what's your strategy in this market and also how do you manage to compete with them with the 3P business model? Thanks.

<A - Richard Qiangdong Liu>: Yeah. So for now, we actually have our first-party fresh product business group. So on a 1P basis, we do have very decent – actually a very, very fast-growing first-party fresh business in the Tier 1 cities. And then we also have the existing O2O initiative with Walmart and Yonghui. So through the Dada network, we are seeing increasing traction, especially in Tier 1 cities, that consumers are increasingly adopting this O2O model that we pioneered two years ago