

Q2 2018 Earnings Call

Company Participants

- Christian Arnell, Senior Vice President
- Tian Xu, Vice President-Finance
- Zheng Huang, Chairman & Chief Executive Officer

Other Participants

- Piyush Mubayi, Analyst
- Thomas Chong, Analyst
- Wendy Huang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Pinduoduo Second Quarter 2018 Earnings Conference Call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. I must advise you that this conference is being recorded today Friday, the 31st of August, 2018.

I would now like to hand the conference over to your first speaker today, Mr. Christian Arnell. Thank you. Please go ahead.

Christian Arnell {BIO 19248159 <GO>}

Thank you, Rachel. Hello, everyone and thank you for joining us today. Pinduoduo's earnings release was distributed earlier today and is available on our IR website at investor.pinduoduo.com, as well as GlobeNewswire services. On the call today from Pinduoduo are Mr. Colin Huang, Chairman and Chief Executive Officer, and Mr. Tian Xu, Vice President of Finance.

Colin will review business operations and company highlights followed by Tian who will discuss financials. They will both be available to answer your questions during the Q&A session that follows. Now, let me cover the safe harbor. Today's discussion will contain forward-looking statements. These forward-looking statements involve inherent risks and uncertainties that may cause actual results to differ materially from our current expectations.

Potential risks and uncertainties include but are not limited to those outlined in our public filings with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today and we do not take any obligations to update these

statements except as required under applicable law. Our earnings press release and this call include discussions of certain unaudited non-GAAP financial measures such as non-GAAP operating income and non-GAAP net income (00:01:58) attributable to ordinary shareholders. Our GAAP results and reconciliations of non-GAAP measures to most directly compared GAAP measures can be found in our earnings press release.

It is now my pleasure to introduce our Chairman and Chief Executive Officer, Colin. Colin, please go ahead.

Zheng Huang {BIO 20683053 <GO>}

Thank you, Christian, and thanks everyone for joining us our second quarter results discussion and the first earning call as a public company. I'm pleased to report that we saw robust growth across all our key operation metrics which drove the strong financial performance during the quarter. Last 12 months' GMV grew 583% year-over-year to RMB 262 billion boosted by the more than tripling of our annual active buyers and a doubling of the annual spending per active buyer.

Over the last 12 months, approximately 344 million users had at least one purchase on our platform and we had an average of 195 million MAUs during the second quarter of 2018. These numbers have demonstrated the continued momentum and the rising popularity of the new e-commerce format that we pioneered.

Our revenue for the second quarter 2018 grew almost 25 times over the same period in 2017 and 96% over first quarter of 2018 to RMB 2.7 billion primarily driven by our online marketing services which we launched in April 2017. Both of our revenue outpaced the growth of the GMV demonstrating our ability to drive monetization while maintaining strong growth of GMV.

As this is the first earnings call after we got listed, I would like to take an opportunity to elaborate more about our philosophy behind the business model. We believe value-for-money products has value for everyone. We strive to offer everyone such products through obligating demand for each SKUs, so that merchants - our platform are able to offer each SKU at a more attractive prices.

In order to effectively aggregate the demand, our platform adopted a few innovative features. On one side, we designed our platform to be a browsing and a discovery-based experience. This feature effectively attracts traffic, is not only people with clear purchase intension come to us, but are more so for those who just have some scattered time and like to browse of what it is interesting.

On the other hand, we pioneered the team purchase format, and at the same time leverage the popular social networks to encourage users to share and to purchase together with their social contacts or strangers. These combined efforts help us achieve the demand aggregation I mentioned earlier.

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Furthermore, collective browsing, sharing the purchase actions also give us an opportunity to understand our users much better, not only from their own actions, but also from their social contacts and their influences over or from the people that buy and they browse with. As a result, we would be able to recommend more suitable products to our users, allowing a group of users (00:06:00) similar demands even better, and help them achieve more cost savings given the bulk volume our merchants could enjoy.

As compared to the current players globally, which are mostly focused on solitary efficient shopping, we want to bring our users joy and a sense of connection. And as they interact and they connect on Pinduoduo, more value for money products are naturally made available through a virtuous cycle. We're still far from what we ultimately want to be, but the whole management is working extremely hard towards that.

Next, I will talk about how we plan to get there and at least the first few steps. We couldn't have achieved this level of growth without growing capacity and the capacity of China's manufacturing base today. Over the past few decades, China has grown to become the largest and one of the best manufacturing base for most of the consumer products sold globally. Many merchants and factories could effectively arrange for tailor-made productions if they have visibility on potential orders.

What they lack, however, is the understanding of consumers and expertise and founding for branding and marketing to attract enough consumers. Without effective channels to engage consumers, a lot of merchants and manufacturers have difficulty surviving, while on the other side consumers are in effect craving for more-value-for-money products that can be offered by these merchants and the manufacturers.

What our platform does is to use data analytics to help our merchants better understand the user demand and leverage our unique model to quickly advocate large order volume for their products. In this way those merchants who have previously couldn't afford to go on (00:08:15) offline stores or who couldn't afford to spend huge amount in dollars to attract enough traffic to start their online store elsewhere are given the opportunity to directly engage a large number of consumers and schedule effective productions for popular SKUs.

We hope this mechanism in the longer run could give birth to many original brands, that is brands developed by merchants and manufacturers themselves on our platform and enabled by our platform. In addition, as we help these merchants and manufacturers more jobs will be created. With over 1.7 million active merchants on our platform today, we see significant opportunities for us to help build the next generation of young Chinese brands.

Hopefully, we could also bring these brands to the global market one day. China will not just be a manufacturing base, but also a place with many world's know original (00:09:24) brands tailored to users' need. That's our hope. We have a strong engineering culture since the founding of our company, myself included. Many of the core management have engineering background including key management in operations. We strive to keep this innovative culture. We plan to leverage our engineering know-how to develop our

distributed AI capability to become the enabler of different vertical players in e-commerce ecosystem, including manufacturers, merchants, logistic providers, financial products providers, and among others.

We have spent more money this quarter and have planned to spend even more in the future to keep upgrading our infrastructure to meet increasing traffic and functionality demands, to continue to improve the accuracy of our algorithm to identify problem of problematic products and accuracy of our products recommendation, as well as toward advancing our distributed AI agent network models.

Agriculture industry is an example of the early success of our business model, and we're happy to see the value we've created for consumers and farmers. I discussed this on my Letter to Shareholders earlier that China's agriculture industry is unique and very different from what the United States has. The arable land of China is scattered; hence, mass industrialize the production is more difficult.

Leveraging our unique team (00:11:21) model, we have been able to aggregate end users demands and link them to many farmers directly bypassing layers of intermediaries, especially the information from our platform could help small to medium farms, tailor their produce selection, harvest and a packaging to fit user's need. And our platform can quickly gather large order volume for farmers produced, so that farmers don't need to do or don't need to rely on distributors and suffer from low-bargaining power.

As a result, farmers benefit from a significant increase in their income while consumers on our platform also enjoy cheaper and fresher products. We're proud to have enabled and supported a total of approximately 48,000 merchants located in 330 national level, poverty-stricken countries in China to sell their agricultural products, our platform in 2017.

We are already one of the largest agricultural product platforms in China, and we plan to do so more. Agriculture is just one of the many industries that can be revolutionized by our business model. Similar approach could have been applied to small-to-medium manufacturers be it in apparel, home, 3C or other categories making C2M happen sooner and incubating new brands creating more jobs with the ultimate goal to serve our users better.

Now, let me talk about the recent development of IPO. Many investors are interested in a recent reports on infringing and a counterfeit of products, our platform. I would like to take this opportunity to reiterate that we have and will always have zero tolerance for counterfeit products. We had first and one of the few platforms in China that have insisted on a 10 times penalty of counterfeited products, and we will not compromise on this.

However, we acknowledge that there is still quite a lot to do on eliminating infringement of assets on our platform. That being said, we're consciously and vigorously taking steps to improve. For example, in 2017, we proactively removed a total of 10.7 million problematic products and have blocked 40 million links that have raised infringement issues. The amount of problem products that we proactively removed was 125 times the amount of complaints that we received.

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We have also partnered with over 400 brands to work together on combating counterfeit. As we continue to step-up our efforts to eliminate infringement (00:14:44) from August 2 to August 9th alone, we closed 1,128 stores, removed almost 4.3 million problem products, and blocked over 450,000 links that had infringement issues while working closely with market regulatory authorities to combat counterfeit and infringement of assets. We have already reported 36 cases recently to the local market regulatory authority, and there will be more in the near future.

Every crisis could be an opportunity. What happened was a good reminder for us to speed-up our efforts to help more merchants establish their own brands with the support of our data and the platform. With the volume and supply chain capability, many merchants and manufacturers have - they don't need to infringe.

In addition, we also plan to invest more vigorously in technology to better combat counterfeits and infringement offenses. We upgraded our search algorithm to direct search results towards official brands away from problem products so that the merchants would have less incentive to conduct infringement offenses. We will also invest in our technological capabilities in key word edification and filtering and image text recognition technology.

Additionally, we're in a process of fully upgrading our merchant onboarding system and we will integrate our system with the relevant public security authorities to ensure the authenticity of the merchant identity. We hope that through our continuous effort, more and more merchants will soon come to realize that PDD is a platform that can offer them huge volume due to our effective business model and enable them to grow to the next level. A platform with fair competition among all the merchants and a virtuous cycle of churning less capable merchants' of what we strive for. We look forward to seeing more merchants composing their own new chapters on Pinduoduo.

We are extremely grateful for the past growth given China's strong domestic consumption power and constantly remind ourselves of our social responsibilities as a platform. Our rapid scale up demonstrated the robust domestic consumption demand from the widest consumer base in China and presented a strong case for the potential driver of China's growing economy.

We are committed to enhancing the productivity and the service standard of the industry with our know-how, our data, and our never-ending desire to serve our users. Our goal for the next few quarters will be to enhance the user engagement and trust in our platform, as well as to grow our active user base. Therefore, we have decided to continue devoting substantial resources towards building our brand recognition and user engagement, including sales, and the marketing, and R&D efforts. We have viewed this as a strategic investment for our long-term growth prospectus rather than expenses as we continue to grow. And a good example is our successful branding campaign during the FIFA World Cup 2018.

Last but not least, let's talk about something fun. We attempted to add a more fun element to the experience around Pinduoduo. We launched a game called Duo Duo

Orchard during the second quarter where you can actually grow your own fruit trees. And the most interesting part is that when you harvest your fruits in a game, we actually deliver a box of real fruits to you.

We also blended-in social elements by enabling users to take water from their friends and invite their friends out to the orchard. Users can also complete certain tasks in order to earn more water and nutrition to grow their fruit trees faster. As simple as it might seem, the game actually attracted an overwhelming amount of users. We launched the game in April 2018 and at a peak in June 2018 over 2 million new fruit trees were grown every day.

In the real world, over 300 pounds of fruits are sent from real farms to our users every day, 300 pounds every day. Farmers have benefited from an increase in income due to the large and stable volume of orders coming from Duo Duo Orchard.

Secondly, Duo Duo Orchard is still a very simple game and it is only a very rudimentary attempt for us to bring more fun element to the new e-commerce experience. Nevertheless, we're encouraged by the results that we saw from Duo Duo Orchard and we're confident to bring more innovative and fun features to our platform and get us closer to the long-term ambition of Costco plus Disneyland step-by-step.

We believe that our unique value proposition of offering a comprehensive selection of value-for-money merchandise coupled with a fun, social, and a dynamic shopping experience meets the fundamental demand of all consumers, our current active buyer base is still less than half of the mobile Internet user base in China and that represents significant opportunities for us to continue to grow.

In addition, since we're only three-years-old, many of our users are still new to our platform and they naturally started with selective purchase of products with a smaller ticket size. We believe that as we continue to invest in our brand recognition and improve the Pinduoduo experience, our users will be more comfortable buying more products on our platform as we continue to add suitable SKUs. We're confident in our conviction and ability to capture enormous and growing opportunities in China.

With that, I would hand the call over to our VP of Finance, Tian, who will walk through our financial results in this quarter.

Tian Xu {BIO 20683100 <GO>}

Thank you, Colin. Hello, everyone. Let me go through the financial highlights with you. Our total revenues in the second quarter were RMB 2.7 billion. 87.5% of the total revenues or RMB 2.4 billion were revenues from online marketing services, which increases significantly from the RMB 32 million during the same period last year. The increase was attributable to our GMV and order increases, our increased traffic as shown in our MAU growth as well as our improved user engagement.

12.5% of the total revenues or RMB 338 million were revenues from commission fees which increased from the RMB 72 million during the same period last year. The increase

was primarily attributable to the increase of GMV. Overall, the total revenues increased by 2,489% year-over-year, or 96% quarter-over-quarter.

I would like to reiterate that our online marketing services which we launched last year are still at early stage. We're consistently fine tuning the online marketing product and our phase of monetization. All efforts are focused on providing best user experience and continuously enhancing the user engagement. We always view our monetization as a natural result of our strong value proposition to both our customers and merchant.

Total costs of revenues increased by 260% year-over-year to RMB 388 million from RMB 108 million in the same quarter of 2017. The increase was directionally in line with the growth of GMV and revenue. And the expanded gross margin also reflects an improvement of our operational efficiency. Total operating expenses were RMB 9.0 billion compared with RMB 120 million in the same quarter of 2017.

In particular, sales and marketing expenses rose to nearly RMB 3.0 billion primarily due to an increase in branding campaigns and online and offline advertisement and promotion, as we continue to invest in strengthening our brand recognition and facilitating greater user engagement. General and administrative expenses were RMB 5.8 billion. The increase was primarily due to an increase in head count and then one-off share-based compensation expenses during the quarter, which was disclosed in our prospectus.

Research and development expenses rose to RMB 186 million, primarily due to an increase in head count and the recruitment of very experienced research and development personnel, as well as an increase in the R&D related cloud services expenses. We continue to focus on investing in technologies for the long-term prospects of our platform. Operating losses were RMB 6.6 billion compared with RMB 123 million in the same quarter of last year. Non-GAAP operating losses were RMB 816 million, an increase from the RMB 120 million during the same period last year.

In the second quarter, net loss attributable to ordinary shareholders were RMB 6.5 billion compared with RMB 110 million in the same quarter of last year. Basic and diluted net loss per ADS were RMB 13.40 compared to RMB 0.24 during the same period of last year. Non-GAAP net loss attributable to ordinary shareholders rose to RMB 673 million compared with RMB 107 million in the same quarter last year.

Non-GAAP basic and diluted net loss per ADS were RMB 1.40 compared with RMB 0.24 for the same period of 2017. The non-GAAP adjustment was to exclude the RMB 5.8 billion share-based compensation expenses in Q2. That completes the profit and loss statements for the quarter.

Net cash flow provided by operating activities was RMB 361 million compared with RMB 1.3 billion in the same period last year, primarily due to an increase in outbound cash flow in our sales and marketing spending. As of June 30, 2018, the company had a strong balance sheet with RMB 9.0 billion in cash and cash equivalents, an increase from RMB 3.1 billion as of December 31, 2017. On top of our cash balance, we also have another RMB 1.3 billion of short-term investments. I also would like to take this opportunity to address

some requests and guidance. We understand investors' needs of more visibility of our business. We hope the capital market would understand that we are still too early in our development to provide guidance.

In addition, we prefer to focus more on long-term potential of our platform rather than near-term financial targets. Last but not least, we plan to have better communication with investors in the future in this regard.

This concludes our prepared remarks. Operator, we are now ready to begin the Q&A session. Thanks.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Your first question comes from the line of Thomas Chong from Credit Suisse. Please ask your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi. Good morning. Thanks, management, for taking my questions. I have three questions. The first question is about our outlook for our GMV growth over the next couple of years in terms of opportunities and challenges? And my second question is about our strategic priorities in 2018 and 2019, i.e., is it strengthening our brand or monetization? And thirdly, our long-term outlook in terms of monetization opportunities? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

Okay. Thank you, Thomas. Let me answer your questions one-by-one. Speaking of GMV, I think we are confident that our GMV growth will continue strong year-on-year momentum, and we expect our user base will continue to grow. As of June 2018, we have already achieved 340 million active buyers in the 12-month trailing period and to almost 200 million MAUs, but still far below the mobile Internet population. In addition, the user spending has a large room to grow. In the last quarter, we have almost doubled the user spending compared to the same quarter the year before. So, that's for the GMV.

Your second question is what's the priorities in 2018 and 2019? You asked whether it's about branded recognition or monetization. The monetization, at this moment, is not our higher priority. At this moment, I think doing more branding trying to build up the trust within the users in our platform, and also steadily grow the quality of user base is still our first priority. Your third question goes to monetization. As I just mentioned before, monetization is not our near-term goal, but it is a result and a side effect of the value we've created to both the users and merchants.

We started monetization in mid-2017 and amortization grows very fast. However, we take a conservative approach to grow monetization. We strive to constantly meet users need and to be enabler of our ecosystem including merchants, manufacturers, logistic service

providers, et cetera. For instance, one of our effort is to help capable merchants and manufacturers to develop their own brands, offer training sessions to merchants and to help better manager their online stores and upgrade them to their - update them on their user demographics, seasonal trend and consumer taste, etcetera.

That being said, even though the recent development has a little effect on our traffic and GMV, it did push us, the management, to revisit up our strategies. In order to create a virtuous cycle of attracting more capable and responsible merchants to the platform and churn out some problematic ones, we have decided to systematically going forward in the next period of time to give some free traffic to the proven good merchants, which may affect the monetization pace a little bit in the short-term. But we believe this is the right thing to do to help to drive the ecosystem in a more positive way. And of course, eventually, this will benefit both users and merchants, and as result it will benefit monetization along the long run as well.

Thank you.

Q - Thomas Chong {BIO 21155199 <GO>}

Thank you.

Operator

Your next question comes from the line of the Piyush Mubayi from Goldman Sachs. Please ask your question.

Q - Piyush Mubayi {BIO 1530844 <GO>}

Colin, Tian, congratulations on being a listed company. You mentioned upfront Colin, that you are far from where you want to be. Could you remind us where in the medium term you'd like to be? And extending that question, how would the business model evolve getting to where you want to be in the medium to longer term? And if you could just also talk through the diversification that you'd like, if any, to go through over the next couple of quarters or years?

Second, I know it's very early to talk about monetization levels or the right levels of spending on sales and marketing. But how would you like the market to think about, the market enough to think about the levels of monetization you would aspire towards. And simultaneously, the level of spending that you would like to incur on the business model on the sales and marketing side? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

Okay. Your first question is, okay, medium-term goal and how would the business change. So, yeah, it is still the early stage. And our slogan - or as I was writing in the letter to shareholders, I was imagining PDD could be a combination of Costco plus Disneyland and in that order. So, we're still at the first stage, which is trying to build a Costco, but not add only a single Costco but a collection of Costcos.

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With that said, I mean, we're trying to divide users into different groups through their relationships and through their buying behavior and also their user profile. So that in a big market like China, they will have - we have different types of middle classes in China. And we divide that into let's say 100 or 1,000 groups. And each group will have a set of manufacturers dedicated to them and they are constantly improving and trying to build better quality and better value for money products for that specific group of people.

So that's the very first step we're taking and we're still in that stage. In the process of building a collection of Costco's, we to actually spend a lot of time in two areas. One area is to increase users' trust, build up the brand and trying to reinforce user engagement. The second thing we really have to do is to enhance the supply chain side. We should leverage our data ability and leverage the information we have and also the advantages (00:37:00) model, which has the ability to aggregate a large volume in a shorter period of time.

We hope to push the information we have upstream so that the merchants and the manufacturers can have several days or even several weeks in advance to know what's the volume they are looking at, and what's the planning they can do?

And in the recent developments and attention from the media where also sort of larger program to help the merchants to initiate or start building their own brand. Although building their own brand is not an easy thing. But with the volume, with the data we have and also with the strong manufacturing base in China, I strongly believe in the near future, a lot of brands will be, even global brands, will be originates - will be originated in China. So, that's probably the main task, kind of focus at this stage. Of course, we're making several attempts and little trials in a world of Disneyland, like the Duo Duo Orchard we have just launched. But I have to be honest that at this stage, the Costco part is our main focus.

And your second question goes to our spending and any monetization. Currently, I think, we do see rapid growth in the monetization rate. I don't think too rapid growth is needed, and we should focus more on the user experience. And we're speaking of the monetization level I think we're still at early stage. If we look forward, I think our monetization level should be or could well be at the same level as our peers.

Speaking of the spending, because we think at this stage the growth of the user base and growth of the merchant base, and also the growth of the user engagement is still the key to our success in the long-term. So, we do plan to spend most of the revenues coming into the areas we think is worth of long-term investment.

For instance, some of the TV commercials are good ROI. We think it's a good area to invest to increase our brand awareness. Although it comes to - when it comes to financial reports it's a cost section and it does cut our profit or increase the deficit. But in our own mind a lot of these investments should be treated as a long-term investment and the virtual assets.

So at least in the next few quarters we'll continue to do so in a fairly aggressive way when the opportunity comes. But of course, we will not blindly sort of spend the money regardless what our - although we have a flexible budget opportunities, but we do have very strict standards when we look at ROI. If the ROI is not good, we will not spend the money.

A - Tian Xu {BIO 20683100 <GO>}

Yeah. Piyush this is Tian. Let me add a few color on the monetization. For the 12 months period ending this quarter, our monetization rate was 2.2% increase of 1.6% three months ago which is - the increase is very accretive. However, we are still at early stage. I think the increase have shown our ability to monetize, while still pushing our GMV up.

Our model is fundamentally different from the conventional search-driven inventory index model which has a very long tail of SKUs. We do not need such a long tail of SKUs. So much include - on average get higher traffic per SKU. Therefore, we believe we could be more - those merchants will be more willing to pay on our platform. And our monetization rate in the long term could be potentially higher than some other e-commerce platform. Thank you.

Q - Piyush Mubayi {BIO 1530844 <GO>}

Thank you. And congratulations again.

A - Zheng Huang {BIO 20683053 <GO>}

Thanks.

Operator

Your next question comes from the line of Natalie Wu from CICC (00:42:15). Please ask your question.

Hi. Good morning, management. Thank you very much for taking the question. This is (00:42:24) speaking on behalf of Natalie (00:42:25). I have two questions here. First question is regarding the recent PR incident on infringing or counterfeit products that management just mentioned. So, can management share some thoughts on whether you view this impact as a temporary one or rather long-lasting risk as though we're taking a lot of efforts, is this hard to solve all this kind of problem at one time? That's my first question.

And my second question is about competition. We see some of our competitors like Taobao and DingDong they launched similar team (00:43:02) purchase formats. And recently DingDong also reported very good numbers for its (00:43:08) and Taobao, we see some media reports that Taobao also launch to embed similar functions in its main app. So, do management see any impacts or changes in competition so far? And how should they think about the competition landscape going forward? Thank you very much.

A - Zheng Huang {BIO 20683053 <GO>}

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Okay. For the first question, the combat against the counterfeit goods. I think our stance against the counterfeit goods was always firm and very clear. Only shortly after Pinduoduo's inception, we adopted the very strict 10-times penalty policy, which was the very first time in the whole industry. Although, it is a very hard fight against the counterfeit good products and against the programmatic (00:44:07) merchants, and we did receive strong fight backs, but we never gave up and we all compromised.

The recent development and media attention, honestly, had a little effect on the business itself, but it does help us reflect and revisit many of our policies. We deeply understand that regardless the existing problems the industry has, it doesn't give us any excuse for not facing the problem directly and fighting against the problem wholeheartedly.

Instead, as a newcomer to the industry, we view it as an opportunity for us to establish and create - to create and establish unique value for the society by solving the hard problems in innovative way, as we innovated the (00:45:11) model, we innovated the new user interactive formats. I think - although it's a long battle, but we are confident that we will be able to win.

More specifically in 2017, we proactively removed more than 10 million programmatic products and have blocked 40 million links that raised infringement issues. We have also partnered with over 400 brands to work together to combat counterfeits. In the recent weeks, we closed down over 1,000 stores and reported a batch of cases to the market regulators.

At the same time, we also plan to speed up our effort to help more merchants establish their own brands. We can give merchants opportunities to directly engage a large number of consumers. In addition, we will also collaborate with the government to offer the merchants with the channel to speed up their trademark registration process. At the same time, in addition we'll also upgrade our technology to better combat counterfeits and infringement offenses including better search algorithm, image and motion recognition technology, integrating our system with the public security authorities, et cetera.

So all of this is kind of - it's a short-term campaign. It's also a long-term effort. It's a hard battle, but I think our stance is very firm and clear. And the media attention in the short term did give us some pressure, but it also poses opportunity for us to create unique value to solve the problem that - which is hard and which is good for the society, so that's the first question.

Your second question goes to competition. You mentioned some other platforms also launched similar features. But one thing I want to point out is that, this kind of attempts - it's not their first attempt, a similar product, similar campaigns had been launched a while ago even one year ago, the major peers have been made several attempts already. We are confident that our differentiated business model and the value proposition will provide more value for many products and far experience to the users. And this is very different from the solitary utility driven and a social-based experience. The recent trend of

many players using the team purchase format actually validates our business model, and we always welcome such kind of friendly competition.

Q - Operator

Thank you very much.

A - Zheng Huang {BIO 20683053 <GO>}

Thanks.

Operator

You next question comes from the line of Wendy Huang from Macquarie. Please ask your question.

Q - Wendy Huang {BIO 15034507 <GO>}

Thank you, management. Congratulations on solid first earnings results, as a sell-side analyst as well as a heavy user of the Pinduoduo. I have a few questions on the operations and a few questions on the financial side. First, can you give us a breakdown among your 1.7 million merchants, what's the number of the brands versus the number of old manufacturers? And also, you mentioned a lot about different categories such as agricultural. So, is there any color you can share about GMV breakdown by different categories? And also, you mentioned about the SKU in the previous comment. Is there any number regarding the SKU you can provide here?

On the financial side, I noticed gross margin expanded 9 percentage points to 86%. Can you provide some color regarding the reason behind the expansion, and how should we look at this going forward? And also, on the SBC, this quarter, there's RMB 5.8 million, a very big amount of SBC. Shall we take this as a one-off, and how should we look at SBC going forward? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

Okay. Your first question goes to the breakdown of our fees, and whether we have sort of the platform unique SKUs. It is slightly difficult for us to check as not all merchants would tell us, and tallying that number is not the best use of our time. However, we could see for some SKUs listed in our platform that cannot be found elsewhere, for example, some of the tissue papers and agricultural products are not from the store - are not from the - are actually from the stores directly, and can hardly find on other platforms. We are still at early stage of enabling merchants to tailor make small batches for products to user needs, but these are some early signs of what we could achieve.

We frequently provide supports for our merchants to help them achieve better performance in our platforms. For instance, we offer training sessions to merchants to better manage the financials. We periodically provide reports consumer behaviors to improve their marketing efforts. In addition, we are also working with the government to speed up merchant trademark registration process through us.

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Our automated goal is to satisfy our users. We believe that our platform role is to create a fair and healthy environment for the merchants to serve their users well. We do our best to enable our ecosystem players and align our goals to achieve that. With that said, we don't really put a strong emphasis on this category or on that category or we're trying to sort of specifically drive traffic to a particular category or a particular set of SKUs. But we do have programs recently launched that we plan to sort of give for traffic or give some stipend to good quality merchants, so that we can faster improve the ecosystem and the quality base of the merchants. Your second question is about the January break down?

Q - Wendy Huang {BIO 15034507 <GO>}

Yeah. The...

A - Zheng Huang {BIO 20683053 <GO>}

Okay.

Q - Wendy Huang {BIO 15034507 <GO>}

...merchant break down between the brands versus non-brands and also the January break down by different industries, for example, agricultural, electronics and etcetera?

A - Zheng Huang {BIO 20683053 <GO>}

Okay. We will treat - well, actually we don't treat brand and non-brand so differently. We actually believe a lot of the non-brands will become China-originated brand in the near future. We will treat brand and non-brand merchants equally. Our goal is always to better serve our user and create a fair platform. And merchants will do well if they can serve the users well.

So, we don't do this kind of division. And a lot of times it's hard to tell. Some of the brands are famous. I could say this is a famous brand, but some of the new brands are not so famous but they also have a label on it. It's also in future they may become very famous brands.

Speaking of category breakdown, we don't disclose the exact numbers at this moment, but what I can tell you is that the agricultural part is a feature, and compared to our peers, this category plays a bigger role in our platform. But we're doing not so well in the 3C sector at this moment. And your third question is about the stock compensation. Right? I will hand that over to Tian about the compensation, but in general it's a onetime thing.

A - Tian Xu {BIO 20683100 <GO>}

Yeah. Hi, Wendy. You've got two questions about finance, firstly about the high-gross margin last quarter. Yes, we did have a high-gross margin last quarter about 86%. I would like to say as a platform model, our gross margin should naturally be high and in the long-term, we're still enjoying high gross margin. The fundamental reason is because if you look at our cost of revenues, the major (00:55:15) payment processing fee, cloud service cost, et cetera, et cetera.

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So in terms of payment processing fee, it's more or less in line with the growth of the GMV. But however, all the other parts, like server costs, customer service costs, et cetera are more like at a stable growth rate. So we can definitely enjoy economy of scale in that sense. That's partially the reason why we have a high gross margin last quarter.

And on the other side, when you look at our revenues because we have early stage - at an early stage of our monetization, our revenues went up dramatically and there might be some fluctuations from time to time. So this also drove our gross margin really high last quarter and probably we're keeping high (00:56:07) but in the long way, the gross margin will be high but probably not as high as last quarter's level. So that's what we can provide to you.

When it comes to FBC, yes that RMB 1.8 billion is definitely one-off share-based compensation. It was arranged since last round of financing but only shown on our financial statements this quarter. So this is to confirm that's one-off impact on our financial statements. Thank you.

Q - Wendy Huang {BIO 15034507 <GO>}

Thank you.

Operator

There are no further questions at this time. I would now like to hand the conference back to today's presenter.

Colin, please continue.

A - Zheng Huang {BIO 20683053 <GO>}

Okay. Thank you.

A - Christian Arnell {BIO 19248159 <GO>}

Thank you everyone, for joining our call today. In closing and on behalf of the entire management team here at Pinduoduo, I'd like to thank you for your interest and participation in today's call. If you have any questions or concerns, please don't hesitate to reach out to the Investor Relations team. This concludes the call. Thank you very much.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now, all, disconnect.

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