

## Q4 2020 Earnings Call

### Company Participants

- David Liu, Vice President of Strategy
- Jason Shu, Investor Relation
- Lei Chen, Chief Executive Officer
- Tony Ma, Vice President of Finance

### Other Participants

- Alicia Yap, Analyst
- Binnie Wong
- Eddy Wang, Analyst
- Natalie Wu, Analyst
- Piyush Roy, Analyst
- Thomas Chong, Analyst

### Presentation

#### Operator

Ladies and gentlemen, thank you for standing by and welcome to Pinduoduo Fourth Quarter 2020 Earnings Conference Call. At this time all participants are in a listen-only mode. After speaker's presentation, there will be a question-and-answer session. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference to the first speaker today, Mr. Jason Shu. Thank you. Please go ahead, sir.

#### Jason Shu {BIO 20677992 <GO>}

Thank you, AJ [ph]. Hello everyone and thank you for joining us today. Pinduoduo earnings release was distributed earlier and is available on the IR website at [investor.pinduoduo.com](https://investor.pinduoduo.com) as well as through GlobeNewswire services. On today's call are CEO, Chen Lei who will make some general remarks on our performance for the past year and our strategic focus going forward, our VP of Strategy, David Liu will then elaborate further on specific strategic initiatives, our VP of Finance, Tony Ma will then take us through our financial results for the fourth quarter and fiscal year 2020 ended December 31, 2020.

So, before we begin, I would like to refer you to our Safe Harbor statement in the earnings press release which applies to this call as we will make certain forward-looking

statements.

Also, this call includes discussions of certain non-GAAP financial measures. So please refer to our earnings release, which contains a reconciliation of the non-GAAP measures to GAAP measures. Now it is my pleasure to introduce our chief executive officer, Chen Lei. Please go ahead.

## **Lei Chen** {BIO 18939623 <GO>}

Thank you, Jason, and hello everyone. Thank you for joining us on our earnings call for the fourth quarter and the fiscal year 2020. Pinduoduo delivered another quarter of strong growth and solid execution and our users continue to (inaudible) with their purchases.

Our annual active buyers increased 57 million in Q4 to reach 788 million for the trailing 12 months. User engagement has also accelerated. Our MAU increased to 720 million, total number of orders placed on our platform increased by 94% to reach 38.3 billion in 2020.

Total revenues excluding revenues from merchandise sales for Q4 was RMB21.2 billion, an increase of 96% from a year ago. Non-GAAP operating loss narrowed in Q4 for the same quarter a year ago. 2020 was a challenging year for Pinduoduo as it was for many others.

The COVID-19 pandemic which by now already stretched over to years[ph] has put our team and platform through a tough test since we were founded six years ago. It has been a humbling experience for us. I'm glad that we have responded quickly and responsibly to continue serving our users better, whereby winning their invaluable trust.

I would like to thank our users and our team for their continued support. As we transition from 2020 to 2021, I would like to share some takeaways and do a recap of this very long year. First, 2020 has been dictated our view from the get go, which is that separation of the online and offline work is increasingly irrelevant.

With advent of mobile Internet, online and offline are just parts of a single word, rendered together more and more seamlessly and complementary to each other. Unlike with desktops, smartphone users could go online anywhere, anytime and for any length of time.

Users no longer have to carve out time and be confined to a specific place, which is common practice for desktop era. This is why six years ago, we insisted on developing a mobile only platform for our users. In fact, we are only one among Internet companies of our scale to be mobile-only to-date.

If anything COVID-19 has accelerated with branding, it was already happening fast even pre-COVID-19. Today, the younger generation that grew up with smartphones are not even conscious about (inaudible) seamless transition they make each day between online and offline.

Among other age groups, China's highly advanced online payment system and mobile communication tools have also made it clear -- made it nearly impossible to do anything purely offline. This has in turn has increased familiarity and acceptance of this (inaudible).

With COVID-19, the adjustments that we have had to make our routines have only expanded online space and as excited is branding with offline space. Consumers are able to frequent brick and mortar shops turned to online platforms like a Pinduoduo to purchase food and other groceries.

(inaudible) preserve of wet markets which Chinese families visit, not just to get grocery but as a social activity. Users are able to travel back home to spend Chinese New Year with loved ones, have also (inaudible) to deliver walk[ph]. They either send caretakers or food and clothing to loved ones living elsewhere or order (inaudible) home for themselves.

We rose to the challenge of delivering best service to our customers. We went further than we had before. Over the Chinese New Year holiday, we worked with merchants to stay open and dispatch orders. We also worked with the logistic partners to ensure that a million delivery men were deployed to deliver parcels.

We fulfilled a surge of orders for Hong Kong delicacy. As for fresh produce and groceries, we provide the consumers with the most of what they wanted quickly and affordably. Consumers did not have to stop before a long Chinese New Year break.

In this way, we have to fill a gap left by brick and mortar shops, thereby bringing value to our users. Going forward, Pinduoduo, as a pioneer in this space, we will book -- we will build on the lessons we have learned and doubled down to improve our offerings to our users.

We will always be on look out for new ways to create more value for them. Second, 2020 has highlighted that we can do more for agriculture sectors and rural communities. Pinduoduo started off by selling fresh produce online. It was a conscious decision because we found them to be a necessity and optimizing the production, distribution and consumption would bring a great piece of widespread benefit.

On the penetration of agriculture sectors has also consistently lagged industry average. We have never lost sight of this beginning and agriculture has consistently been a strategic priority for us. We are proud to be China's largest agriculture platform. Our GMV for agricultural products doubled to more than RMB270 billion in 2020; 12 million farmers sold their produce directly to consumers via our platform. We are among leading technology companies commended for making outstanding contribution for the war on rural poverty. We see these affirming our investment to bring solutions to optimize every part of agriculture value chain.

In 2020, we also launched live-stream sessions for farming communities and dedicated channels to promote their products to leave difficulties brought about by COVID-19. We

observe that order volumes were so large with our sellers and deliver partners had issues fulfilling, especially in the summer.

To solve this, in August, we launched Duo Duo grocery, our next day grocery pickup service to help local farmers and distributors to sell directly to consumers, increasing sales and cutting waste and cost for customers. Pinduoduo's vision of Costco type business started from agricultural products in the farmland.

We are now already the largest agricultural platform in China. We can do more. We hope that in the next stage Pinduoduo will become world's largest agriculture and grocery platform and then make groceries source the (inaudible) affordable and available to all users. To this end, we aim to build our equity focus logistics infrastructure platform that will reduce waste, lower costs and speed up delivery for agricultural products. This is a work in progress, we expect to make a few more years of investment before you can realize its full potential has achieved efficiency.

We shared our vision of contributing to China's agriculture sector with technology. To help increase the resilience of the food chain has paid off the blooming global food crisis. We will continue to invest in agriculture and food technology and look into global investment opportunities in our (inaudible) for the safety and precision farming.

Third, 2020 has also made a small committed than ever to continue to promote this total inclusion of rural communities this advantage. Pinduoduo has created a level playing field for business of all sizes including in agricultural sector where margins are thinner. In addition, live streaming and online business on our platform have created new rules that prioritize different skillsets as a lot inclusion of users whom otherwise would be excluded.

For instance, agriculture is traditionally labor intensive, women and physically weaker people may not be able to participate in it. Live stream and online business operations do not exert the same physical requirements, as these individuals are able to participating in them.

In fact of our stores actively engaged in the sale of agriculture products, over half are managed by women. This is a win-win situation for everyone. And it raised our commitment to social responsibility, we definitely want to and we'll do more here, including by providing further training for them to sell well on our platform.

Last but not least, many of you have learned that Colin will step -- stepping down from his Chairman role effective today. On behalf of us all, we would like to thank him for his leadership and the contribution to Pinduoduo in the past six years.

We were shaking on, as he explores new frontiers for Pinduoduo in years to come. As the new Chairman of the Board, I would like to ensure everyone that -- ensure everyone that our strategy remains the same which is to stay true to our value benefit and provide a more saving, more cost benefits to serve our users on our platform.

We are proud that we have become the world's largest e-commerce platform by user number. We will work hard to deliver even better results in years to come. Now let me turn over to David to provide update on our recent initiatives.

## David Liu {BIO 21976168 <GO>}

Thank you, Lei. Hello, everyone, I'll further elaborate some points Lei made just now. First on our continuing efforts to improve the agriculture value chain. Second, on our revenues from merchandise sales and third on our ESG priorities for 2021.

Improving the agriculture sector to benefit our users, that's farmers and consumers, is a central and strategic priority for us. We take a systems space approach to this and devote substantial resources to identify and implement improvements at all stages of the agriculture value chain.

As Lei mentioned, we share the vision of transforming agriculture in China with technology and aim to increase food security. To begin at the Upstream, we'll work with industry partners and universities to introduce more technology to farming.

In 2020, we launched the inaugural smart agriculture competition in partnership with China's Agriculture University, where teams from around the world participated in investigating the use of artificial intelligence in optimizing strawberry planting.

The competition identify cost efficient and scalable technology that can potentially be standardized across China. The winning team has started to commercialize this research findings. Last year Pinduoduo also supported the Global Agrilnno Challenge 2020 which was co-organized by the Food and Agriculture Organization of the United Nation and Zhejiang University.

The competition attracted over 150 teams from around the world to put forward innovative solution to challenges in the distribution and sales of agri food products during COVID-19. AquaFarms Africa, an agritech startup based in Conakry, Guinea won the competition with its technique of aquaponics, which combine fish farming with soil-less vegetable growing, allowing the production of fruit and vegetables are not -- that are normally imported. We will continue investing in the promotion of digital agriculture and precision farming going forward. At the downstream, we have helped over 12 million farmers sell directly to our 788 million consumers.

We trained more than 100,000 new farmers, who will return to their rural communities from urban areas to operate online businesses and vitalize their hometown. We have committed to training another 100,000 new farmers over the next five years. To relieve difficulties brought about by COVID-19, we sponsor live streaming sessions for poverty-stricken farm communities and established dedicated channels to promote their products.

We continue to work with these communities to provide direct access to our consumers. Circling back to the midstream, as mentioned in our earnings call last quarter, the rapid

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increase in orders of for fresh produce particularly leafy vegetables via our platform surfaced the urgent need to develop a dedicated logistics infrastructure to deliver fresh produce to our users in the optimal condition, at compelling prices and within 24 hours.

This new solution goes beyond streamlining distribution, you will be different from existing ones and it will take time, resources and multiple iterations for us to eventually arrive at what works best.

However, we believe that we have made some progress in the right direction through Duo Duo grocery, our next day grocery pickup service that intelligently connects local farmers and distributors directly to local consumers, thereby reducing spoilage from storage and transport. We have been increasing the number of agriculture producers and regional distributors and expanding the number of pickup points.

However, there is still so much more we can do. We need to make substantial investment in people, technology, potentially capital assets. While our preference is to work with strategic partners towards this goal, we are prepared to make equity investments to expedite the requisite development or purchase assets in places where they are unavailable.

We are prepared to persevere in this endeavor, even though it could take some time to play -- pay off. As we are confident of how it will benefit our users, we hope that investors will be patient and supportive of this challenging and meaningful endeavor.

Next, I would like to say a few words regarding our revenues from merchandise sales. This quarter, you will have noticed that we are reporting additional revenue line item, merchandise sales. This line item captures the revenues generated from the 1-P trials we started last year. In our 1-P trial, we aimed to temporarily fill the gap of missing product our users need on our platform, while we looked for merchants who can offer these products on our marketplace. We have no plan to grow this business, we expect this line item to remain very small percentage of total GMV we generate. As of Q4, it is less than 1% of total GMV we generated.

Now onto our ESG priorities for 2021. As we continue to manage the challenges caused by the global health crisis, we are passing to reflect on what more we can contribute to a more sustainable and equitable future. Specifically, we have identified the following ESG priorities for 2021. Firstly, continue to promote digital inclusion in rural communities.

As China's largest agriculture platform with 788 million users, we firmly believe in playing our part to empower people and businesses to take part in the digital economy. Since our inception, we have connected farmers directly with consumers, coach them and setting out stores online, provided them with access to end demand and helped them to increase household income.

Our efforts have helped more than 100,000 young men and women return to their hometown and become e-commerce savvy new farmers. They are down from -- to

become champions of digital inclusion often catalyzing a multiplier effect and wealth creation for their local communities.

We have also partnered with China Post and farmers cooperatives to bring agriculture products from remote areas to the national market to boost rural income. In this three way collaboration, China Post local offices open online stores on Pinduoduo and source directly from agricultural co-ops. This approach has proven very effective in helping to tackle rural poverty.

Looking ahead, we are continuing our efforts to work with local communities, regulators and academics in modernizing farming practices. In addition, we see technology, such as the finding from our smart agriculture competition last year, to play a more central role in driving China's agriculture revolution. We also see investment opportunities in food and agriculture technology that we can help to extend across farms in China.

Secondly, continue to empower women and the physically challenged, Pinduoduo's zero additional commission policy and our SKU oriented recommendation approach creates a more level playing field for smaller entrepreneurs. We have seen many success stories on our platform for women and physically challenged entrepreneurs who might otherwise be excluded from the offline job markets. As Lei mentioned, we are and will continue to provide more training to enable these entrepreneurs and look forward to helping them create further success stories on our platform.

Thirdly, continue to make our service greener and more efficient. Pinduoduo is committed to protecting the environment, and as we mentioned in our ESG report last year, we're investing in technology and working with our logistics partners to optimize delivery route planning.

We are also investing in research and development of green packaging design and materials, we're working with our merchants to eliminate excess of packaging and providing them with more suitable environmentally friendly solutions, such as different sizes and biodegradable materials. We see ourselves making a positive difference for the environment especially as order volumes on our platform rise.

Now, let me pass the floor to Tony to discuss our financial results.

**Tony Ma** {BIO 19978312 <GO>}

Thank you, David. Now, let me take you through our financial results for the quarter and fiscal year ended December 31, 2020. Our annual active buyers for the last 12 months ending December 31, 2020 grew by over 200 million from the end of 2019 to 788 million.

Our MAUs in Q4 grew by 77 million from the prior quarter to reach 720 million or an increase of 50% from the same quarter in 2019. Our MAUs in Q4 as a percentage of our annual active buyer exceeded 90% for the first time, which we see as a reflection that we are satisfying the needs of more users.

Our last 12-months GMV for 2020 grew to RMB1.67 trillion representing 66% year-on-year growth. In comparison, our average annual spending per active buyer increased 23% to RMB2115. The lower rate of increase should be considered in the context of substantial increase of 203 million active buyers over the past year.

Most of these new users are still building trust with our platform and have contributed less than a full year worth of purchases in 2020. We continue to observe that as our users season on the platform, they make purchases across more categories and they increase their average spending over time in each category.

We did observe an increase in purchase frequency in 2020, partly due to the grocery business we launched. In 2020, our platform generated a total of 38.3 billion orders or an average of 49 orders per active buyer. This is an increase of 44% from a year ago. As the average order value of grocery are lower than our platform average, our AOV came down 15% to RMB43.5 in 2020 as compared to RMB51.1 in 2019.

Please note that starting from Q1 2021, we will retire the disclosure of quarterly GMV, but we will continue to disclose full-year GMV, which is the practice adopted by our peers. Since our IPO, when we were operating as a straightforward marketplace model, we have reported both quarterly and annually GMV on the same basis as our peers, in order to provide the public with a meaningful parameter to assess our progress as a new market entry.

However, as the complexity of our business grows, quarterly GMV is increasingly less relevant to evaluate our overall business, nor is it reflective of our strategic priorities, especially when we do not manage our business against the quarterly GMV targets. As our revenues grew in scale and with the introduction of new initiatives such as Duo Duo grocery and our IP trials, we would encourage investors to focus on our P&L and cash flow metrics going forward to assess our ability to generate sustainable value.

In terms of P&L, our total revenues in this quarter end December 31, 2020 were RMB26.5 billion, up 146% from RMB10.8 billion in the same quarter last year. As David mentioned, we reported a revenue from merchandise sales of our IP trials this quarter. While it is the contribution of our IP trials to our GMV is negligible, we are reporting it as a separate line item as it accounts for 20% of our total revenue in Q4.

To give you an apples-to-apples comparison excluding revenue contribution from IP trials, our total revenue grew by 96% to RMB21.2 billion in Q4 2020. The main driver of this growth was our online marketing services. Online marketing services revenue was RMB18.9 billion this quarter, up 95% compared to the same period last year due primarily to an increase in merchants recognition of our platform's capability to help them reach to their target buyers effectively and efficiently. Our merchants are spending more on our platform, because of our constantly improving services and also the increasing user traffic. Our online marketing services revenue as a percentage of our GMV in the last 12 months ended December 2020 was 2.9% as compared to 2.7% for the same period ending in December 2019.



We are pleased to see the growing endorsement by our merchants and our users. Our transaction service revenue this quarter amounted to RMB2.3 billion which is up 105% compared with the same period last year. On the trailing 12-months basis, our transaction service revenues as a percentage of our GMV has been quite stable at around 0.3%.

Now, moving on to cost. Our total cost of revenues increased from RMB2 billion in Q4 2019 to RMB11.5 billion this quarter. The increase in our cost of revenues was mainly due to the cost associated with the 1P merchandise sales. Costs related to the operation of Duo Duo Grocery such as warehouse rental cost and higher cost of cloud services, call center and merchant support services.

The total operating expenses this quarter were RMB17.1 billion as compared to RMB10.9 billion in the same quarter of 2019. On a non-GAAP basis, our total operating expenses as a percentage of our revenue excluding the 1P contribution has been declining from 112% to 94% to 76% for Q4 of 2018, 2019 and 2020 respectively.

The gradual improvement continues to demonstrate the operating leverage in our business model. Our sales and marketing expenses this quarter increased to 59% to RMB14.7 billion from RMB9.3 billion in the same quarter of 2019. This is mainly due to an increase in online and offline advertisements and promotions.

As we continue to invest in user engagement in my share, on a non-GAAP basis, our sales and marketing as a percentage of our revenue, excluding 1P trials this quarter was 68% as compared to 84% and 103% for the same quarter in 2019 and in 2018. The decrease in sales and marketing as a percentage of revenue, excluding 1P trials has demonstrated scale of economy and the fact that our strategy of having a higher bar of ROI in our sales and marketing investment has worked well. In fact, since we started Pinduoduo, we have cumulatively spent RMB\$81 billion in sales and marketing expenses. On a non-GAAP basis, which averages to about RMB103 per active buying users, we have accumulated it up to date.

We will continue to consider our sales and marketing division holistically and invest whenever we see opportunity that meet our ROI requirements. On a non-GAAP basis, our general and administrative expenses were RMB153 million, an increase of 26% from RMB121 million in the same quarter of 2019, primarily due to an increase in headcount. Our non-GAAP research and development expenses were RMB1.56 billion, an increase of 65% from RMB943 million in the same quarter of 2019. The increase was primarily due to an increase in headcount and the recruitment of more experienced R&D personnel as well as an increase in the R&D related cloud service expenses. On a non-GAAP basis, our R&D expenses as a percentage of our revenue excluding the 1-P contribution this quarter was 7.3% as compared to 8.7% for the same quarter last year.

Now, to sum up, operating loss for the quarter was RMB2 billion on a GAAP basis compared with operating loss of RMB2.1 billion in the same quarter of 2019. Non-GAAP operating loss was RMB1.1 billion compared with operating loss of RMB1.3 billion in the same quarter of 2019.

Net loss attributable to ordinary shareholders was RMB1.38 billion as compared to net loss of RMB1.75 billion in the same quarter last year. Basic and diluted net loss per ADS were RMB1.13 compared with RMB1.52 in the same quarter of 2019.

Non-GAAP net loss attributable to ordinary shareholders were RMB185 million compared with RMB815 million in the same quarter last year. Now, GAAP basic and diluted net loss per ADS were RMB0.15 compared with RMB0.72 in the same quarter of 2019.

That completes the profit and loss statement for the fourth quarter. Our net cash flow from operating activities was RMB14.9 billion compared with RMB 9.6 billion in the same quarter of 2019, primarily due to an increase in online marketing services revenues. Net cash used in investing activities in this quarter increased from RMB 11.5 billion in 2019 to RMB 26.6 billion.

The increase was primarily due to our decision to invest a portion of our cash reserve in cash management products. As of December 31, 2020, the company has RMB 87 billion in cash, cash equivalents and short-term investments.

As of the end of Feb 2021, US \$712 million of our 0% convertible bonds due in 2024 has been converted into equity. Thank you, operator, we are ready for questions.

## Questions And Answers

### Operator

Certainly. (Operator Instructions). We have the first question from the line of Binnie Wong from HSBC. Please go ahead.

### Q - Binnie Wong {BIO 16260213 <GO>}

Hi, good evening management, congrats on such a very robust quarter to conclude 2020. I have two questions here, first question actually on the user side. So you look at the users as you have an amazing 788 million, that of course surpassed your peers and is one of the largest.

So can you help us understand what are the strategy that you have used to deliver such growth and how would you think you can sustain that in terms of this user engagement at all. My second question is also on the -- is actually on the community food purchase, I think you mentioned, it is a 3P model, just want to take a bit of guidance in terms of the accounting-wise. So how does it really work in terms of your commission paid to the community group leaders or is it that more some of it will be transacted by our marketplace platform.

So I guess it's just in terms of faster, but understand the accounting, how it really work and also in terms of the profit. I mean like on the GP dollars side, how much losses are we running at, if you can give us some idea, not necessarily numerically if this is not at the

right level to disclose, but I guess more just in terms of clarity as to how we should think about the investments that we do need for the rest of the year.

And I think management has mentioned about the infrastructure, the logistics side of things as well. So that'll be great. Thank you.

**A - Jason Shu** {BIO 20677992 <GO>}

Hey, thanks Bennie. Why don't I ask Lei to address the first part of your question and then I will have Tony talk a little bit of accounting. For some of the technical stuff, we can take it offline as well.

**A - Lei Chen** {BIO 18939623 <GO>}

Hi, so we continue to observe very good momentum in terms of our user growth and in each of the past four quarters, we added on average over 50 million annual active buyers for each quarter of them. Not being said, as we are approaching 800 million user landmark and it's -- (inaudible) that our user growth will slow down, but as we always said that we are less focused on the user numbers and that we are more focused on UD users' satisfaction and trust by bringing them the best shopping experience and the value for money products.

And we believe that as long as we can continuously serve our users well and we will keep growing and thanks to trusting us and so one sector, we are actually we always, our priority is in the agricultural sector. Not only is agriculture digitized by mobile Internet, it is also the greatest widespread benefit, that's where we can create as a big platform.

And we are now China's largest agricultural platform and so in the future we will commit to do more for agriculture sector is and rural communities and the other thing, I'd talk to about is -- the future is integrated word online, offline.

Yeah, definitely, we are targeting this kind of new word. So I think about it and you really need to look at it wider retail market. So, today China's total retail sales for consumables already reached RMB39 trillion in 2020 and it is expected to grow at 5% per year over the next five years and if you take a look at our number, so our GMV stands at only 4% target.

So I believe as consumer behavior of online and offline continue to integrate and an opportunity for us, we definitely will continue to expand.

**A - Tony Ma** {BIO 19978312 <GO>}

Let me pick up on the second question on Duo Duo Grocery, I guess. And as you mentioned, Du Duo Grocery we operated as the 3P offering. From an accounting point of view, we generate transaction service revenues for the service provided to our merchants and some farmers.

The contribution in Q4 and fiscal year 2020 of the total Grocery Products was immaterial and most of the cost associated of running Duo Duo Grocery operation such as

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warehouse rental, delivery logistics and captured and our cost of revenues. Just a note, Duo Duo Grocery is a very young business, I mean we just started with a few months and it is still evolving.

But we are very confident about this business model and it brings significant value to our consumers and other participants among this value chain and a few key drivers we can think of on the new e-site, let's take, if we are able to streamline unnecessary layers of the distribution and each layer traditionally would take up a meaningful mark up, so a more efficient supply chain would also mean less of spoilage and all of these factors putting together will definitely bring additional value to the stake for all the participants, the stakeholders to share in this business model. But like I said, the development on the infrastructure on the whole process will take time to be there. So, at this moment profitability won't be a target for us to fix Duo Duo Grocery.

### **A - David Liu** {BIO 21976168 <GO>}

Yeah, Toni, I just want to add on top of that to say that at the end of 2020 we are the largest E-commerce platform by users already and as we have always talked about focusing on engagement really is the core of our strategy and we are confident now with an even further enlarged base that continues to grow at good momentum, we should be able to drive even better engagement and Duo Duo Grocery really plays into that by giving us an additional access point to address the needs that we previously couldn't have.

So we have high hopes for the Duo Duo Grocery business because it is integral, it is the expansion of our overall platform and as the model evolves, I think you know the rules of the different constituents of the Duo Duo Grocery ecosystem may also evolve as well. So stay tuned and bear with us, we think this could be tremendous opportunity. We are confident that we will be able to execute, but it will take some iterations to find the perfect model.

Why don't we move onto the next question.

### **Operator**

Thank you. The next question comes from the line of Thomas Chong from Jefferies. Please go ahead.

### **Q - Thomas Chong** {BIO 21155199 <GO>}

Hi. Good evening. Thanks management for taking my questions. I think in the prepared remarks management comments about Duo Duo Maicai as the merchandise sales, which is a 1P trial piece of this and is sort of a trend to the GMV. So I just want to get a sense about when the business is getting bigger and bigger, should we expect the merchandise sales continue to decline in absolute amounts in coming quarters. And on that point, is it possible to give us some color about the GP margin of this 1P trial business as well as the overall Duo Duo Maicai GP margin as well.

And my second question is about the GMV growth, I think management also talked about the focus on monetization, how should we think about the GMV per buyer going forward. Thank you.

## A - David Liu {BIO 21976168 <GO>}

Sure, Thomas. I think you asked quite a number of questions in your two questions. So let me try to maybe take that in bits and pieces of it. The first thing I want to make clear, if there is any confusion is that the merchandise business -- merchandise sales business that we are reporting as an additional revenue item has nothing to do with Duo Duo grocery or Duo Duo Maicai. So we are referring this say to as Duo Duo Grocery in English going forward.

So the 1P merchandise sales business has nothing to do with Duo Duo Grocery, so I want to make sure that is very clear. The 1P business as we mentioned is because we have noticed that our consumer demands on our platform, which we haven't been able to identify the appropriate merchants for and we had to step in these situations temporarily to make sure that our users can find the product they want at the prices that they are looking for.

So, because this is a temporary measure, we have no intention to grow this into a larger scale business. In the fourth quarter, the 1P business is less than 1% our GMV and I think you should expect that to stay as a small percentage of our GMV going forward. As to Duo Duo Maicai, it is -- as Tony mentioned, it is a very new business initiative and the business model continues to evolve, I would say -- the first thing I do want to take the opportunity to clarify is that the Duo Duo Grocery business itself is not a community group purchase business.

It's important that the investors understand this distinction because it impacts, I think your understanding of how the economics works. right. So first of all, it is not a typical community group purchase because unlike group purchases where neighbors or group leaders are sort of owners actually aggregates a group and earn a commission for organizing that purchase. With an active buyer base of 788 million users, Duo Duo Grocery does not actually rely on community leaders to attract users and users can just place order independently by themselves through our app.

So this is the reason why we are approaching Duo Duo Grocery as an integrated and an extension of our e-commerce platform. So the economics accordingly and the type of roles that these group leaders play are quite different. Second thing I would say is, we introduced Duo Duo grocery to cater to this rising demand that consumers have for convenient, affordable grocery and it is now available in 300 cities across China.

A key part of this offering is really the agriculture focused logistic infrastructure that we are working to build and the idea here is to really reduce waste to lower costs and to speed up delivery of agriculture products. To that end, we are leaning on technology to achieve better quality control, better sourcing, better forecasting of demand, which can now reduce wastage and improve supply chain efficiency.

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We are working with third-party providers now to make strategic investment where needed to accelerate the build-out of the necessary infrastructure so we can achieve less than 24 hour turnaround time for the orders. We believe that as proven out in the last five and half years, as long as we remain laser focused on anticipating and meeting the user's needs, users will continue to vote for us with their wallets.

I think Thomas, you also asked about gross margin trends and with regards to the individual businesses. We're not going to comment on the specifics, but suffice to say that excluding the impact of our first-party merchandise business, which as I mentioned earlier in my remarks is still small, this business is loss-making. If we actually exclude the impact of the 1P business, the fourth quarter bottom line and margins are actually very much similar to the non-GAAP net margins we reported in the third quarter.

And I think lastly, you talked about ARPUs or spending per user, look I think without taking too much time, I would just say that with the user base that we have and with the focus that we are spending around engagements, we are very confident that the, as user activity grows, the availability of merchandise on our platform will grow and as the user seasons on our platform, as we have seen in the past, they will continue to shop across more categories, they will make more purchases within those categories because that's the trust level built that mind share, the market share or wallet share we have with them will also grow.

So we are quite confident with the outlook on the ARPU. The way I would think about the monetization front, you alluded to earlier or is, let's say, the 3.2% kind of LTM monetization you've seen in the fourth quarter, that really is an endorsement of the merchants. I'm seeing good conversion for the advertising spend. And that is only possible if the user activities are translating into sales. So, let me actually stop there and then move on to the next question.

## Operator

Thank you, David. The next question comes from the line of Alicia Yap from Citigroup. Please go ahead. H

### Q - Alicia Yap {BIO 15274658 <GO>}

Hi thank you and good evening management. Thanks for taking my questions. I have very two quick ones. One is, I wanted to follow up on what exactly is the item category in these 1P trials that we have. And then second is could management comment on the Duo Duo Grocery performance. I know it is still early but then how do you rate the performance so far for the quarter fourth quarter, is that in-line, above or below your internal expectations. Thank you.

### A - David Liu {BIO 21976168 <GO>}

I'm sorry Alicia -- I was distracted, but on your question regarding the 1P business, the product categories is actually quite diversified. How we approach it there was really identify looking at items or SKUs on our platform, where we know they are clear consumer

demands, but we are unable to source sufficient merchants for it. So the product categories are quite diverse and then the strategy itself, it is not category specific.

The second thing I would say is -- to your question regarding the progress of Duo Duo Grocery, as both I think, Lei and Tony have commented, this is a very long-term commitment for us and because we think the opportunity is immense and because we think we can really create some value here for the users.

So, as such, I think we are experimenting as we move forward and as I mentioned earlier in my response, the service is now available across the nation in over 300 cities. So, I think we are pretty comfortable with the progress or the pace of that rollout on a geographic footprint. What is more interesting from our perspective, however is to build and develop a corresponding infrastructure network, right. It's easy to drive user growth and particularly for platform like us, we actually have a very intrinsic advantage that it gets from a traffic perspective. The question we are more concerned about is what investments do we need and how can we deliver the right type of user opportunities to the user experience to address the opportunities we see.

Because I think one of the few elements of success to the Duo Duo Grocery business in our mind, I guess maybe to highlight two things in particular, one of which is the sourcing and forecasting, right. How much you can sell or how or what price -- what price can you sell the SKU for ultimately depends on your ability to forecast the demand properly and be able to organize the pricing around it in the most efficient way possible.

And of course the second part of it is an infrastructure that can be aligned appropriately and largely for agriculture and fresh produce such that we can arrange the fulfillment and deliver in less than 24 hour type of the cycle.

So, we are still really in the very early innings of what we consider it to be kind of our approach to grocery business in China and I think we are pleased with the progress that we have made so far. But there are definitely still a lot more we can do.

**Q - Alicia Yap** {BIO 15274658 <GO>}

Okay, thank you.

**A - Jason Shu** {BIO 20677992 <GO>}

The next question please.

**Operator**

Thank you. The next question comes from the line of Natalie Wu from Haitong International. Please go ahead.

**Q - Natalie Wu** {BIO 19852429 <GO>}

Hi, good evening. Thanks for taking my question. It's a little bit add about synergy -- synergy question of the last quarter just wondering what kind of the synergy between Duo Duo Grocery and you're original marketplace as such in terms of the supply chain, should we expect in the longer term future and what could drive what's happening right now.

And also wondering if that could be the key competitive edge that for you and other competitors in the longer run.

**A - David Liu** {BIO 21976168 <GO>}

Thank you, Natalie. So as we have discussed, we can see Duo Duo Grocery really as an integrated part of our marketplace, right. So, it is an extension of the experiences that we can offer. It is an extension of our ability to address more of consumers needs and use.

So, from listening to what we have said about being focused on building our infrastructure, the idea is really to figure out how we can address their needs better. Post review, continuing to leverage on the existing express delivery infrastructure network as well as to develop this less than 24 hour type of fulfillment infrastructure for Duo Duo Grocery.

If we can organize both of these delivery logistics very efficiently and actually be able to forecast and recommend the appropriate SKUs to consumers based on their desirables use case and fulfillment case, we actually see a lot of opportunities to drive synergy between the platform marketplace today and the Duo Duo Grocery scenarios.

And certainly on the supply chain side, as I mentioned earlier most of the suppliers today are local. That said, there are 12 million farmers on PDD today who are sourcing and who are supplying to our users on a nationwide basis. These will all be potential sellers or suppliers into the Duo Duo Grocery scenario provided that they have enough support around logistics and via our coordination.

So, certainly over time, I think we see the infrastructure being able to support not only locally-driven supplier, but on a nationwide basis to really leverage the supply chain available on PDD's marketplace also extend beyond pure agricultural produce and this is the reason why Lei, in his remarks pointed out that we are -- our vision is really to become China's largest agriculture producer and by doing so in that process become the largest grocer for the world.

**Q - Natalie Wu** {BIO 19852429 <GO>}

Got it. That's great. Thank you.

**Operator**

Thank you. We have our next question from the line of Piyush Roy from Goldman Sachs. Please go ahead.



## Q - Piyush Roy

Thank you very much. My first question is about the comment in Colin's letter to shareholders, where he mentioned that traditional approach to competing -- of competing through scale and efficiency has its inevitable limitations. I wonder if you could elaborate. And in the interest of time, I wonder if you could talk through the impact of Duo Duo Grocery on the broader business, i.e., when I look at your take rates, they are a record high of 323 and you expanded on that.

When I look at your sales and marketing spend is that it's one of the lowest we've seen at 77.8, if you strip out the merchandise sales, and just look at marketing services, but that seems to be the start in the right direction. If you could just expand on that and also elaborate on if possible in the limited time, the impact of Duo Duo Grocery on the gross profit line, that would be great. Thank you.

## A - David Liu {BIO 21976168 <GO>}

Hi Piyush, I think the way you should think about the Duo Duo Grocery's impact on the business model overall is highly synergistic, right -- in the sense that we now have an incremental scenario of being able to fulfill the user's needs that we previously weren't able to address. So that increases our ability to address that need over time.

And because of that, we certainly expect the engagement overall on the platform to continue to improve and as more users become more familiar with our platform, we also expect their spending will continue to improve. So one of things that I think you may notice that is from an average order value perspective for the year, it has actually decreased well over that of the prior year.

But you need to take that in the context of the significant number of user adds and also the increasing order numbers. So we are quite confident and actually as the business continues -- as the users continue to mature on our platform, with the improvement and engagement level, this will continue to trend in the right direction and resulting in more operating efficiency that, Piyush, you have identified.

In the interest of time, why don't we take one last question and....

## Operator

Definitely, we have the next question from the line of Eddy Wang from Morgan Stanley. Please go ahead.

## Q - Eddy Wang {BIO 19169337 <GO>}

Thank you management for taking my question. The question is also related to the (inaudible). As you mentioned that Duo Duo Grocery is not a community group purchase business, but if we look at the competition in the first quarter actually you're competing with the other community group purchase players and you said that or next step will be enlarging kind of -- to have the warehouse and agriculture focused logistics.

So just want to know you also whether not in terms of this, all these players now the next focus for you will be the infrastructure investment and user engagement instead of the user acquisition, maybe, well in the past of six months and how, what's your view on the competition -- in terms of cash flow, to online cash flow in this year. Thank you.

#### **A - David Liu** {BIO 21976168 <GO>}

Sure, Eddy. thank you for that. So we are obviously not in a position to comment on other players strategy. But as we -- so I would say, let's focus on what we are doing, right. So if you look at what PDD is today, we are an e-commerce platform with 780 million users, highly active users at that rate.

So the MAU for the quarter was 720 million. So, almost 90% of my annual active user and we are confident that the user engagement metrics will continue to trend. As we have communicated to the past quarters, growing user base has never really been our priority but the entire year was really focused on engagement, that with better engagement, with better trust building on the platform, the user number has -- we have seen very strong growth momentum in that. But as Lei mentioned, given the scale of our user base today, it's inevitable that user growth will start to trend down and it's much more important that we are focused on engagement and focused on satisfying their needs on our platform.

And Duo Duo Grocery providing us the opportunity to, I wish to say, incremental opportunity to address that additional aspect of needs for groceries, afford grocery on more timely basis and at more compelling value.

And I think it's important to recognize the fact that to do Duo Duo Grocery appropriately, we as a platform do need to become more heavy. It is an operational heavier business, we are getting involved in warehousing operations, we're getting involved in delivery logistics operations. So the investments in the offline operations will be an important part of the stress[ph] factor, but I would say -- in thinking through the competitive dynamic, it's important not to lose sight. The strategic advantage that we as a platform with 700 or almost 800 million users have over in this business model, right.

So, we will continue to focus what we have been doing well, which is understanding what consumers are looking for, recommending them the most appropriate product based on our understanding of what their needs are, what their expectation of value for money is and except the difference is now instead of having to rely only our express delivery, we actually have an additional fulfillment mechanism that can actually enable a shorter turn around of delivery for particular categories of product out where that timing sensitivity actually matters, right.

So, we are fully committed to making sure that we have the right infrastructure in place to win in this business because we think by doing this right, the opportunity is immense and is highly synergistic to the marketplace business that we continue to see a very long runway for.

#### **Q - Eddy Wang** {BIO 19169337 <GO>}

Thank you.

**A - Jason Shu** {BIO 20677992 <GO>}

With that we will wrap up the call for the evening. Thank you very much everyone for your time and look forward to speaking again in the next quarter.

**Q - Eddy Wang** {BIO 19169337 <GO>}

Thank you.

**Operator**

Thank you, ladies and gentlemen, That concludes the conference today, thank you for participating, you may all disconnect now. Thank you.

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